No. 12,539

In the United States Court of Appeals for the Ninth Circuit

A. BRIGHAM ROSE AND ZELLETTA ROSE; LORI, LTD., INCORPORATED; ZELLETTA M. ROSE AND A. BRIGHAM ROSE, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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v.

Commissioner of Internal Revenue, respondent [1]

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OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 426-455) are not officially reported.

JURISDICTION

The petition for review here involves deficiencies in individual income taxes and statutory additions thereto (50% fraud penalties) (R. 11-15, 506-510, 525-531); and corporate income, excess profits and declared-value excess profits taxes, 50% fraud penalties, and also 25% negli-

[1] This cause embraced four factually-related cases (T.C. Docket Nos. 5138, 5157, 11737 and 11738) which were consolidated for purposes of hearing, findings of fact and opinion in the Tax Court (R. 3, 22, 29-32, 83, 426-455; Pet. Br. 2), pursuant to the taxpayers' motion for consolidation of trial of all four cases, granted by the Tax Court on June 10, 1946 (R. 2; Tr. 13). The cases are brought here by the taxpayers' joint petition for review by this Court. (R. 541-546.) (The "Tr." references herein are to the documents in the original transcript of record on file in this Court.)

gence penalties (R. 468-479); all of which were asserted, variously, by the Commissioner against the several taxpayers for the taxable years 1938 to 1941, inclusive (R. 426-427, 436-440). The deficiencies were asserted by the Commissioner as follows: On March 3, 1944, the Commissioner mailed to the individual taxpayers, A. Brigham Rose and his wife, Zelletta Rose, a joint notice of deficiencies in income taxes and 50% fraud penalties in the respective sums of $1,658.81 and $829.41 for the calendar year 1940. (R. 11-15.) On March 7, 1944, he mailed to the corporate taxpayer, Lori, Ltd., Inc. (hereinafter called Lori, or the corporation), a statutory notice asserting deficiencies in income, excess profits and declared-value excess profits taxes, 50% fraud penalties, and also 25% negligence penalties in the aggregate sums of $26,736.95 (taxes), $13,-368.50 (50% fraud penalties) and $1,477.66 (25% negligence penalties), respectively, for the calendar years 1938 to 1941, inclusive. (R. 468-479.) In his answer filed in the Tax Court on July 24, 1944, the Commissioner alleged and asserted additional liability against Lori for 25% negligence penalties in the aggregate sum of $3,052.35 for the taxable years 1938 and 1939—over and above those asserted for 1940 and 1941 in the statutory notice of March 7, 1944—for failure to have filed proper and adequate corporate income and excess-profits tax returns (Form 1120), as required by the statute and Regulations, for 1938 and 1939. (R. 479-491.) Finally, on May 9, 1946, the Commissioner mailed to the two individual taxpayers separate notices asserting deficiencies in income taxes against taxpayer Zelletta M. Rose in the aggregate sum of $3,098.85 for the calendar years 1939 and 1941 (R. 506-510), and deficiencies in income taxes and 50% fraud penalties against taxpayer A. Brigham Rose in the total sum of $5,891.45 and $2,-945.73, respectively, for the calendar years 1938, 1939 and 1941 (R. 525-531; Tr. 64, 74).

Within 90 days after the above-mentioned deficiency notices were mailed, the taxpayers filed with the Tax Court appropriate petitions for redetermination of such deficiencies in taxes and penalties on May 31, 1944, June 2, 1944,

and August 7, 1946, respectively (R. 7-15, 456-479, 498-510, 513-531), under the provisions of Section 272 of the Internal Revenue Code. Upon the taxpayers' submitting for the first time further data and evidence at the hearing of the cases, the Commissioner made various concessions and adjustments in their favor (R. 440, 445-446), as did the Tax Court upon still further new evidence being adduced by them (R. 440-441, 447, 449-450). Thereupon, upon giving effect to such adjustments (Tr. 35, 61, 71, 8), and denying the taxpayers' two motions for rehearing (R. 4-5; Tr. 31, 39), the decisions of the Tax Court sustaining in part the several deficiencies in question to the extent of $16,866.17 (taxes) and $9,279.43 (penalties) were entered on November 21, 1949. (R. 455-456, 497-498, 512-513, 540.) The cases are brought to this Court by the taxpayers' joint petition for review filed on February 17, 1950 (R. 541-546), pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTIONS PRESENTED

1. Whether the Tax Court correctly found, upon all the evidence, that the taxpayers failed to meet the requisite burden of overcoming the *prima facie* correctness of the Commissioner's determination that, in the absence of adequate books or records, the amounts of their taxable net income realized for the years 1938 to 1941, inclusive, were —except to the extent of the adjustments made by the Tax Court upon the taxpayers' furnishing additional evidence at the hearing below—not less than the sums on which the several deficiencies were computed on the bases of the increases in the taxpayers' net worth for each of those years.

2. Whether the Tax Court erred in declining, for lack of proof, to exclude from taxpayer Rose's taxable income, as redetermined by it for the years 1939 to 1941, inclusive, the sums of $10,000, $1,456.76 and $7,005.32, allegedly representing Rose's personal loans deposited in Lori's bank account, and other amounts (legal fee, $6,500, and salary

from Lori, $1,200) improperly included in his taxable income, for those years.

3. (This question not presented below): Whether taxpayer Rose's financial statements—adduced in evidence by the Commissioner for comparative purposes in respect of his determination of the taxpayers' increases in net worth for the taxable years—adjusted to the cash receipts and disbursements basis upon which the taxpayers' returns were filed, confirm the alleged truth and accuracy of their returns as filed.

4. Whether the Tax Court erred in including in the community net income of taxpayers Rose and wife the value of their living quarters which they received rent-free from Lori during the taxable years.

5. (This question not raised below): Whether the Tax Court erred in including his wife's one-half community share of his income in taxpayer Rose's taxable income for the year 1938, for which he filed a single return and she filed no return.

6. Whether the Tax Court correctly found that the basis of taxpayer Rose's Silver King Coalition Mines stock allowable for determining the long-term capital loss claimed by the taxpayers upon the sale thereof in 1941, was not greater than the sum of $4,500 determined by the Commissioner as the cost thereof as of the date of acquisition.

7. Whether the Tax Court erred in sustaining the Commissioner's determination allowing taxpayer Rose and his wife deductions for depreciation on their Vine Street property only to the extent substantiated by them, and disallowing the remainder, together with Lori's claimed deductions for depreciation on its Villa Courts property, for lack of proof.

8. (This question not raised below): Whether the Tax Court properly recognized the corporate identity of the Lori corporation for income tax purposes.

9. Whether the Tax Court correctly sustained the Commissioner's determination disallowing, for lack of proof,

Lori's claimed deductions for 1938 and 1939 in the aggregate sums of $10,748.62 and $6,107.21, respectively, for "related expenses" paid by others out of funds received by them from Lori which in turn received "gross sums" from the Brevoort Enterprises, Inc., representing their combined unsegregated rental receipts under the joint leases of the Hotel and the Villa Courts held and operated by Brevoort and Lori, respectively.

10. Whether the Tax Court erred in declining, for lack of proof, to exclude from Lori's gross income the sums aggregating $8,156.76, alleged by the taxpayers to have represented taxpayer Rose's individual loans deposited in Lori's bank account during 1939 to 1941, inclusive, and also the sums totaling $3,955 purportedly representing Rose's moneys transferred from his bank accounts to Lori's accounts during those years but not being income to Lori because they were not rentals allocable to its Villa Courts property.

11. (This question not presented below): Whether taxpayer Lori is entitled to excess profits credits in the determination of its excess profits tax liability for any of the taxable years involved.

12. Whether the Tax Court properly found that the taxpayers failed to overcome, in large part, the presumptive correctness of the Commissioner's determinations of deficiencies and statutory additions thereto (50% fraud penalties) for the taxable years 1938 to 1941, inclusive, on the ground that the record as a whole indicates that the taxpayers filed fraudulent returns, and that they intended by their actions and omissions to evade taxes for each of those years, within the meaning of Section 293 (b) of the Revenue Act of 1938 and the Internal Revenue Code.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and Regulations are printed in the Appendix, *infra.*

STATEMENT

The facts were found by the Tax Court as follows (R. 428-449):

The taxpayers A. Brigham Rose and Zelletta Rose are husband and wife domiciled in the State of California. (Hereinafter, A. Brigham Rose will be referred to as taxpayer Rose or Rose, unless otherwise indicated.) They filed their income tax returns for the years 1938 to 1941, inclusive, on a cash-calendar year basis, giving the address of taxpayer Rose's office at 205 South Broadway, Los Angeles, California. The returns were filed with the Collector for the Sixth District of California. (R. 428.)

Lori, Ltd., Incorporated, is a corporation organized under the laws of California in 1935, with its principal offices stated to be in the taxpayer's office. It was authorized by its charter to engage in general business activities, and did engage in the business of holding real estate. At all times material, taxpayer Rose was president and treasurer of Lori, and was in sole control of its operations. Without necessity of any additional authorization or any signature other than his own, he could withdraw funds from Lori's bank account. (R. 428.)

Of the six issued shares of stock of Lori, two were held by taxpayer Rose, two were issued in the name of Paul Angelillo, who was its vice-president, and was also an attorney associated with taxpayer Rose maintaining his office at the same address, and the remaining two shares were issued in the name of P. M. Woods, the stepfather of Mary Allen, who was a client of Rose. It was contemplated by Rose that additional shares of stock should be issued by Lori to him but this was never done. (R. 428-429.)

Taxpayer Rose and his wife came to California in 1927, at which time he was admitted to the Bar and commenced the practice of law. Since that time he has engaged in the practice of that profession in Los Angeles. (R. 429.)

Taxpayers Rose filed an income tax return, Form 1040,

for the year 1938, on which appeared, in addition to his name and address, only the following (R. 429):

> From various interests and personally, have handled sum greatly in excess of $5,000.00 for the taxable year of 1938, but have expended and borrowed a sum in excess of the amount handled, but unfortunately, the records requisite to rely on for details are not available to me for diverse reasons. I am, therefore, making this return: That I Owe Nothing, and will supplement this Income Tax Return on request.

Taxpayers Rose and his wife filed separate returns for the year 1939 on a community property basis. There was reported therein a net community loss of $4,232.71 from rental property, and net income of $10,312.55 from legal business. The total gross receipts from legal business were stated on the returns to be in the amount of $17,154.78. The net community income reported on the returns of taxpayers Rose and his wife for the year 1939, after all deductions, was $6,079.84. (R. 429-430.)

A joint tax return was filed by taxpayers Rose and his wife for the calendar year 1940, reporting net income of $2,636.57. Included in that total was net income from his legal business amounting to $1,411.66. (R. 430.)

For the year 1941 separate returns were filed by taxpayers Rose and his wife disclosing community receipts in the amount of $29,719.76. Included therein was net profit from legal business of $31,758.27. Deductions for contributions, interest, and bad debts aggregating $729.56 were claimed. (R. 430.)

During the years 1938 and 1939 taxpayer Rose carried three checking accounts in his own name with the Citizens National Trust and Savings Bank of Los Angeles. Two of the accounts remained active through 1941. The accounts were designated: A. Brigham Rose, Attorney Account; A. Brigham Rose, Special Account, and A. Brigham Rose, Trustee Account. (R. 430.)

During those years, the balances, deposits, and withdrawals in these accounts were in the following amounts (R. 430-431):

	1938	*1939*	*1940*	*1941*
Balance 1/1	$45.94	$356.18	$24.17	$28.96
Deposits:				
A.B.R. (Atty. Acct.)	$880.00	$1,449.50	.....	.....
A.B.R. (Spec. Acct.)	28,715.84	16,738.66	$7,458.74	$7,966.00
A.B.R. (Trustee Acct.)	14,058.11	12,461.10	8,559.35	5,298.00
Total	$43,653.95	$30,698.96	$16,018.09	$13,264.00
Withdrawals:				
	1938	*1939*	*1940*	*1941*
A.B.R. (Atty. Acct.)	$879.83	$1,512.40	.....	.....
A.B.R. (Spec. Acct.)	28,952.26	16,884.68	$7,457.68	$7,954.77
A.B.R. (Trustee Acct.)	13,871.62	12,633.89	8,555.62	5,317.91
Total	$43,343.71	$31,030.97	$16,013.30	$13,272.68
Balance 12/31	$356.18	$24.17	$28.96	$20.28

Taxpayer Rose used all of these accounts, as well as the Lori account (R. 445, 446-447) for his personal deposits and expenditures, and the Lori account, in particular, was used as a "sanctuary" from his creditors who had on previous occasions attached his own accounts. (R. 431.)

During all of these years taxpayer Rose's principal sources of income were from his professional fees, from rents of property which he owned, and from certain real estate operations in which Lori was interested, the actual operations being handled during part of the period by Brevoort Enterprises, Inc. (hereinafter called Brevoort), a California corporation organized in 1935. (R. 431.)

Taxpayer Rose's interest in the real estate operations of Lori dates back to 1931, when he and his wife signed a note for $12,000 to be held as additional security to the holder of a first trust deed covering a hotel structure consisting of 78 rooms located in Hollywood, which was then owned by the Hotel Investment Company, of which Rose was president and attorney. The first trust deed secured an obligation of approximately $93,000. The management

of the hotel was conducted by one Robert L. Warner who was, at that time, connected by marriage to the family owning the stock of the Hotel Company, under leasing arrangement not shown in the record. At the rear and adjoining the hotel were nine bungalows known as the Villa Courts. These were originally acquired by a member of the family which at one time held the stock of Hotel Investment Company, were later transferred to that company, were then transferred to Warner, were later deeded to taxpayer Rose, and in 1935 were conveyed by him to Lori. (R. 431-432.)

At the time taxpayer Rose signed and executed the note for $12,000, he was living in the hotel. Also, living in the hotel was one Mary Allen, for whom Rose drew a so-called spendthrift trust in 1932. Mary Allen was under the care of a nurse and was incompetent to handle her own affairs at that time. The corpus of the trust consisted of 30 railroad bonds and other securities, which she had obtained as the result of an action brought against members of her family, in which she was represented by taxpayer Rose. These securities were turned over to Warner, a business associate of Rose, who was named trustee to serve without bond. The trust was drawn by Rose as attorney for Mary Allen. In all matters in connection therewith Mary Allen acted under the advice of Rose until 1941. Shortly after the creation of this trust, Warner invested unspecified amounts of the trust funds in the hotel and Villa properties, and also in another adjoining property on Vine Street which was subject to a second mortgage held by taxpayer Rose. No accounting was made by Warner or requested of him by Rose, although Rose was attorney for Mary Allen, and was also financially involved in the operation of the hotel, the Villa Courts, and the Vine Street property. The investment of these funds by Warner in these various properties precipitated his resignation in 1935 after an investigation by Mary Allen's father.[2] At

[2] Not to be confused with P. M. Woods, previously referred to as Mary Allen's stepfather. About the latter (Woods) we know

about that time one Paul Angelillo, a lawyer associated with taxpayer Rose, acquired title to the hotel property and Rose as trustee acquired title to the Villa Courts which he then conveyed to Lori. Paul Angelillo conveyed the legal title to the hotel property to taxpayer Rose's wife in 1944. The Vine Street property was bought in by Rose personally in 1936 at a foreclosure sale involving a first mortgage thereon. Taxpayer Rose's bid at the foreclosure sale was $22,100. This property included the land and three buildings. The hotel property, title to which was in Angelillo, and the Villa Courts, title to which was in Lori, were beneficially owned by Rose, subject to the encumbrances against them and the unliquidated claim of Mary (Allen) Woods against Rose, arising out of the trust of which she was beneficiary. Her claim was in 1941 formally recognized when Rose agreed to pay her $200 a month during her life, which obligation was to be secured by mortgages covering the hotel properties and the Villa Courts, pursuant to a contract by which Rose agreed to cause Angelillo to mortgage the Hotel property and Lori to mortgage the Villa Courts. (R. 432-434.)

In 1938 taxpayer Rose appointed himself as trustee of the Mary Allen trust, but did not, at that time or later, transfer, or cause to be transferred to himself as trustee, any of the properties here involved. During all of the years involved Rose made certain payments to her, most of which the Commissioner allowed as deductions. (R. 434.)

In 1938 at least three accounts reflected proceeds from the operation of the hotel and courts. These were the so-called "Harry J. Wall, Special Account" at the Citizens

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little except that he was a sailor and had died before the hearing herein (R. 433) on July 7-10, 1947 (R. 3).

The record shows that Mary Allen, also referred to, variously, in the testimony and exhibits and by the Tax Court as "Mary Woods", "Mary Allen Towle", and/or "Mary Allen Woods" (R. 73, 115, 118-124, 141, 297-301, 429, 432, 433, 443; Exs. 2, 3, 96), was Mary Allen Fuqua, "formerly known as Mary Allen" (R. 359; Ex. HH).

Bank, an account at that bank in the name of "Brevoort Enterprises, Inc.", and the bank account of Lori. Wall was manager of the hotel and Villa properties during 1938. During 1938 and 1939 taxpayer Rose also advanced funds from his own accounts for the operation of the hotel. (R. 434.)

Taxpayer Rose freely transferred funds between all of these accounts without maintaining any records or without making any segregation of income, expenditures, or indebtedness of himself or the various corporate entities. (R. 434.)

During 1938, Wall maintained certain receipts and disbursements records which disclosed receipts from the hotel and the Villa properties for that year in excess of $40,000. For the month of January, 1938, the record differential between the income and the disbursements was $785.79; for February $1,175.78; for March $601.05; for April $359.96; for May $556.72; for June $888; for July $199.92; for August $536.36; for September $349.22, and for October $285.15. The various expenses of the operation through the month of April, 1938, were paid by checks written on the Wall account. This account became inactive in May, 1938, and thereafter many disbursements by check were made by taxpayer Rose from his special account. (R. 434-435.)

During all years material in these proceedings, taxpayer Rose had unrestricted use of all of the funds passing through the accounts of Brevoort and Lori. (R. 435.)

In February, 1939, Brevoort executed a five-year lease on the hotel and the Villa Courts to F. A. Linck. The lease provided for monthly payments of $1,200 as rental and an advance payment of $4,800 covering the last four months of the leasehold term. (R. 435.)

In May, 1940, Linck, in effect, surrendered the lease and a new lease contract was executed between Lori and Paul Angelillo as lessors on one hand, and G. W. Nickson and E. Sternglanz, as lessees, on the other, covering the re-

mainder of the term of the original lease. Under this new lease, all rentals were payable to taxpayer Rose and the new lessees were given credit for the $4,800 advance payment theretofore made by Linck. It was also provided that the lessees were to be allowed $100 a month as a rebate on their rent for a period of three years to cover improvements and repairs. (R. 435.)

The understanding effected between Rose, Lori and Angelillo was that of the receipts under the lease, one-third was to be credited to Lori and two-thirds to the hotel properties, title to which was in Angelillo's name held, however, for Rose's beneficial interest. This arrangement was carried out commencing in 1940. (R. 435-436.)

Because of the failure of the taxpayers to maintain any books and records of their income and expenditures, other than miscellaneous cancelled checks and loose receipts, the Commissioner found it necessary to reconstruct their taxable income by reference to bank deposits and other evidences of receipt of income for the years 1938 through 1941. (R. 436.)

At the time of the investigation of the income of the taxpayers, the Commissioner requested that taxpayer Rose furnish accounting or other records from which his income and the income of the various corporate entities could be determined. In response to this request, Rose presented only some cancelled checks and unclassified miscellaneous receipts. Thereafter, taxpayer Rose was required to appear in the Federal District Court in response to the Commissioner's order for the production of records. No additional significant information was forthcoming. None of the taxpayers maintained any books or records reflecting their income and disbursements, nor any other documents which adequately reflected this information for any of the years involved. (R. 436.)

The net income which formed the basis of the deficiencies in these proceedings was based upon a determination that all unidentified bank deposits were taxable receipts; that

payments made by taxpayer Rose to the hotel operating company represented loans to that company for operating expenses, and that personal and business expenses paid by taxpayer Rose by means of checks written on the Lori bank account constituted payments of constructive dividends taxable to him to the extent that they were not otherwise explained. The income so attributed to taxpayer Rose, as set forth in the deficiency notices, results from the computation of income and identifiable deductions (R. 436-437), as set forth in detail by the Tax Court in its findings (R. 438-439, 440, fn. (a)), and summarized as follows (R. 440):

	1938	*1939*	*1940*	*1941*
Net income per return.....	none	$3,039.92	$2,636.57	$14,495.10
Net income from profession	$8,172.55	8,195.90	3,905.22	(3,643.63)
	$8,172.55	$11,235.82	$6,541.79	$10,851.47
Plus other net income additions	18,202.17	6,635.54	10,474.61	8,104.18
Net income adjusted per statutory notices	$26,374.72	$17,871.36	$17,016.40	$18,955.65

* * * * *

By reason of identification of additional checks and other evidence subsequently made available by taxpayer Rose at the hearing, the Commissioner recognized that the community income as determined in the statutory notices should be reduced for the years 1938 and 1939 in the respective amounts of $3,355 and $2,565, representing returns of advances made by Rose to Brevoort. There should be further reductions of the sum of $1,100 for 1938, and $355 for 1939, reflecting the return by Lori to taxpayer Rose of advances on its behalf. (R. 440.)

In addition to the amounts allowed by the Commissioner (R. 440) as deductions in the notice of deficiency and the concessions and adjustments indicated in the paragraph above, taxpayer Rose established his right to decrease the

taxable income determined by the Commissioner in the following amounts (R. 441):

1938	
Interest	$553.12
Transfers between accounts	638.00
Payments to Mary Allen	160.77
Payments to L. A. Wholesalers benefit	1,616.00
Current operating expenses of Lori and Hotel paid from bank accounts of Rose	10,748.62
Total	$13,716.51
1939	
Bank loans	$500.00
Payments to Mary Allen	124.94
Transfers between accounts	355.00
Payments to L. A. Wholesalers benefit	285.00
Receipts under lease, properly accountable for by Lori and Hotel	3,600.00
Current operating expenses of Lori and Hotel paid from bank accounts of Rose	6,107.21
Total	$10,972.15
1940	
Receipts under lease, properly accountable for by Lori and Hotel	$1,956.41
1941	
Receipts under lease, properly accountable for by Lori and Hotel	$3,485.00

The expenditures made by taxpayer Rose on behalf of Lori and the hotel operations were out of funds received by Rose from Lori. Lori, in turn, received gross sums from Brevoort covering both the hotel and Villa Court operations. By these expenditures Rose sought to and did thereby protect and preserve his equities in the various properties, the operations of which inured to his benefit. (R. 441.)

Taxpayer Rose's analysis of his bank deposits for 1938 reflected transfers from Lori's account of $6,215 and of unidentified items aggregating $22,283.43. For 1939, receipts from the Lori account totaled $12,331.65, and the sum of $8,247.31 was unidentified. For 1940, receipts from the Lori account were in the amount of $4,476.90, and unidentified deposits were in the sum of $9,069.78. For 1941, taxpayer Rose's analysis further revealed receipts from

the Lori account of $4,229 and unidentified deposits totaling $5,450. (R. 441-442.)

In the years 1939 and 1941 taxpayer Rose received substantial fees for his services in two cases, neither of which was deposited in his various bank accounts. The 1939 fee in the amount of $17,500 was received for services in litigation involving the International Alliance of Theatrical and Stage Employees. Of this amount, $6,500 was deposited in the account of Lori, and the balance was used generally for the payment of a mortgage held by the Occidental Life Insurance Company on the (Vine Street) property which taxpayer Rose had acquired in the foreclosure sale (in 1936). (R. 433, 442.)

In November, 1931, taxpayer Rose received a legal fee in the case of *Howard* v. *Howard* in the amount of $26,727, which was paid to him in two checks. One check was cashed by Rose at his bank, but the proceeds were not deposited to his accounts. Another check in the amount of $16,727 was deposited in the account of Lori. (R. 442.)

In addition to cash income, taxpayer Rose and his wife received from Brevoort, the hotel and Villa Court operators, in the year 1938, meals having a value of $1,200, and received living quarters from Lori in the years 1938 through 1941, having a value of $900 per year. (R. 442-443.)

In the year 1939 taxpayer Rose sold some stock in the Silver King Coalition Mines and claimed a gross long-term capital loss thereon in the community income tax returns. This stock was acquired by him as a result of a suit brought by Mary Allen involving a contest of the will of one Margaret Keith, an aunt of Mary Allen. As a result of this suit, Mary Allen was awarded 4,000 shares of stock in the Silver King Coalition Mines in the year 1934. All of the stock was apparently placed in the hands of Warner, who used it as security for making loans on the hotel property, which he managed in those years. Taxpayer Rose was entitled to a 50% fee on the recovery from the Keith Estate and at some subsequent date prior to 1936, 2,000 shares of such stock were acquired by him in lieu

of a cash fee. The inheritance tax on the assets received by Mary Allen from the Margaret Keith estate was paid in December, 1934, to obtain a release of the 4,000 shares of stock from the Probate Court. Two thousand shares obtained by Mary Allen were used to augment the original Mary Allen Trust and the remainder delivered to Rose at some later date. The 1,200 shares sold by Rose in 1941 represent a portion of this stock. The Commissioner allowed as a basis for this stock the amount of $4,500, the maximum allowable therefore at the date of acquisition. (R. 443.)

Taxpayers Rose and his wife understated rental income received from property which he purchased at the foreclosure sale, by their failure to establish deductible expenses for depreciation applicable to that property in excess of the amounts allowed by the Commissioner. (R. 443-444.)

Taxpayers Rose and his wife failed to include in their income for 1938 and 1939 dividends received on stock of the Silver King Coalition Mines in the sum of $420 for 1938, and in the sum of $300 for 1939. Dividends were overstated in 1940 by the sum of $3.76 for which the Commissioners in the statutory notices made appropriate adjustment. Also, appropriately adjusted by the Commissioner was a deduction in the amount of $288.08 in the year 1940 for interest paid by taxpayer Rose. (R. 444.)

Taxpayers Rose and his wife failed to substantiate a deduction in the amount of $150 claimed as contributions and a loss from bad debts in the amount of $460 in the same year, both of which were disallowed by the Commissioner. (R. 444.)

In 1938, 1939, 1940 and 1942 taxpayer Rose submitted statements of financial condition to the Citizens Bank, in which he listed his assets, net worth, and annual income. These statements reflected the following information (R. 444):

Date	*Assets*	*Net Worth*		*Total Income*
6-11-38	$119,800.00	$103,000.00		$13,500.00
4-29-39	140,900.00	124,400.00	In excess of	10,000.00
3- 1-40	140,000.00	135,000.00	In excess of	20,000.00
9-21-42	183,900.00	178,000.00		41,800.00

Any deficiencies in tax due from taxpayer Rose in the years 1938, 1939 and 1941 and from him and his wife in the year 1940, are due to fraud with intent to evade tax. (R. 444.)

During the years 1938 to 1941 the balances, deposits, and withdrawals of Lori's bank account were as follows (R. 445):

Total Deposits and Withdrawals From Bank Accounts of Lori, Ltd., Inc., for Years 1938-1941

	1938		*1939*	
Bank balance Jan. 1	$436.63		$18.99	
Total Deposits (per bank ledgers)		$25,199.37		$24,723.58
Total Withdrawals (per bank ledgers)		25,617.01		23,678.53
Bank balance Dec. 31	18.99		897.38	

	1940		*1941*	
Bank balance Jan. 1	897.38		495.81	
Total Deposits (per bank ledgers)		18,111.43		34,834.82
Total Withdrawals (per bank ledgers)		18,513.00		35,289.58
Bank balance Dec. 31	495.81		41.05	

In the absence of other evidence, the gross deposits in Lori's bank account for the years involved were assumed by the Commissioner to represent income to the corporate taxpayer, and in the statutory notice those deductions were allowed which could be substantiated by checks written by Lori. The deductions allowed were $44.85 for 1938, $734.83 for 1939, $2,015.34 for 1940, $2,307.98 plus $16,727, representing a portion of a fee of taxpayer Rose deposited in Lori's account, for 1941. (R. 445.) Net income was determined to be as follows (R. 445):

1938	$25,154.42
1939	23,988.75
1940	16,096.09
1941	15,799.84

The availability of additional data led the Commissioner to recognize and concede that Lori's net income as determined in the statutory notices was overstated for the years 1938 and 1939. (R. 446.)

For the year 1938 the overstatement was in the amount of $6,371.39 comprising two items: (a) $5,271.39 representing a deposit on November 7, 1938, which was the greater part of the proceeds of a $7,000 loan to the taxpayers by the California Bank; (b) $1,100 representing a transfer from the Rose Trustee Account on the same date. (R. 446.)

For the year 1939 there was overstatement of net income as shown in the statutory notice in the amount of $15,821.51, composed of three general items: (a) $8,966.51 representing transfers to Lori's account from the bank account of Brevoort and by the collection of rents from the lessee of the hotel and Villa properties; (b) $355 representing four checks drawn on the A. B. Rose Trustee and Special Accounts as advances; (c) $6,500 representing a portion of the fee paid to taxpayer Rose in 1939 in connection with the law suit brought against the International Alliance of Theatrical and Stage Employees. (R. 446.)

The Commissioner properly disallowed, as unsubstantiated, deductions claimed by Lori for the years 1939, 1940 and 1941 which were overstated in the purported corporate returns in the respective amounts of $12,268.18, $1,031.38 and $1,503.92. (R. 446.)

Taxpayer Rose's analysis of Lori's bank deposits reflected the following (R. 446-447):

> (a) For 1938, $16,398.50 represented receipts from the hotel and Villa operations, and $2,429.48 could not be identified;
>
> (b) for 1939, $6,505.26 represented receipts from operations and receipts under the Linck lease, and $1,493.32 could not be accounted for;
>
> (c) for 1940, the sum of $8,930.92 was presumed to be proceeds from the lease of the hotel and the courts, and $6,223.75 could not be identified;
>
> (d) for 1941, the sum of $8,355 was presumed to be proceeds of the lease, and $2,167.50 could not be identified.

Lori's account was used during the years in question as a depository of substantial sums, in which it had no interest, including receipts from taxpayer Rose's law business and sums reflecting receipts from the hotel operations. (R. 445, 447.)

Additional adjustments have been established, as follows (R. 447):

1938	
Paid to Wall for expenses of operation and to adjust gross receipts reflecting both Villa and hotel operations	$9,295.00
1940	
Overstatement of receipts under lease properly allocable to hotel and not Lori	4,130.92
1941	
Overstatement of receipts under lease properly allocable to hotel and not Lori	3,955.00
Deposit of proceeds of personal loan of petitioner	2,605.32
Total	$6,560.32

Any deficiencies against Lori are due to fraud with intent to evade taxes. (R. 449.)

On the basis of the foregoing facts the Tax Court, sustaining in part the Commissioner's several determinations (R. 11-15, 468-479, 506-510, 525-531), found and held that, to the extent redetermined, the amounts of taxable net income in controversy had been properly determined by the Commissioner on the net worth basis from the several taxpayers' bank deposits and other evidence, and that the 50% fraud penalties (individual and corporate) were properly asserted by the Commissioner for all four taxable years involved[3] (R. 449-455). The Tax Court thereupon

[3] The Tax Court also decided adversely to Lori (R. 454-455), the issue involving the 25% negligence penalties imposed and redetermined against it (Tr. 61), under Section 291 of the Revenue Act of 1938 and the Internal Revenue Code, for failure to have filed adequate or any excess profits tax returns for the years 1938-

entered its several decisions accordingly (R. 455-456, 497-498, 512-513, 540), from which the taxpayers petitioned this Court for review (R. 541-546).

SUMMARY OF ARGUMENT

1. The taxpayers kept no books or accurate records during the taxable years from which their taxable income could be ascertained by the Commissioner, as they were required to do by law. Hence, the case is one in which the Commissioner and the Tax Court were compelled to determine their income as best they could from other evidence. In the absence of proper records, the Commissioner's determinations were *prima facie* correct, and the burden was on the taxpayers to prove by competent and relevant evidence that they were wrong, and that their *taxable* income was at least less than the amounts taxed. They have failed to meet such burden. The Commissioner determined and the Tax Court redetermined the taxpayers' income by ascertaining the total increases in their net worth, and adding thereto estimated reasonable amounts, not reflected in such increases, to cover their personal and living expenses. Such method of ascertaining income has been sustained many times by the courts. Moreover, the Tax Court's findings, upon all the evidence to the extent redetermining the Commissioner's determinations of the taxable income and deficiencies here, are fully supported by substantial evidence, and the taxpayers have not shown them to be clearly erroneous.

2. The taxpayers have not proved that the several items claimed to have been personal loans made by taxpayer Rose and currently deposited in Lori's bank account during the years 1939 to 1941, inclusive, constitute proper offsets against like or similar amounts disbursed by the corporation to him or for his account. Taxpayer Rose has not shown that such items were not properly included as

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1941 (R. 427, 470). Since the taxpayers have furnished no argument in connection therewith, we have assumed that they have abandoned the issue.

income by the Commissioner in his determinations of Rose's deficiencies sustained by the Tax Court, that he did not owe Lori such amounts, that they did not represent taxable transactions, or that upon depositing them in Lori's account he did not thereafter draw checks in smaller amounts against such deposits for his own undisclosed purposes, as the record shows he did in innumerable other unidentified transactions, until the full amounts thereof were exhausted. Moreover, the record shows that the portion ($6,500) of Rose's $17,500 legal fee deposited in Lori's account in 1939, now complained of as improperly included in his taxable income for that year, was neither shown to have been deposited in any of his own bank accounts nor reported in his tax return for that year. Hence, he was properly charged therewith as taxable income for 1939. Likewise, the record shows that the remaining item of $1,200 salary he received from Lori and reported as income for 1941, and now claimed as an exclusion from taxable income for that year, was allowed by the Commissioner and the Tax Court, as a reduction from income for salary previously reported in such amount as received from Lori, in the final redetermination of his income for that year.

3. (This issue was neither presented to nor considered by the Tax Court, and should therefore be passed by this Court.) Alternative discussion, if considered here: Taxpayer Rose's financial statements introduced in evidence by the Commissioner, upon adjustment to the cash basis upon which the taxpayers' returns were filed, clearly do not show, as the taxpayers insist, that their returns were correct as filed, and therefore that the Tax Court's redeterminations of their deficiencies in tax liability are erroneous. Such statements were not used by the Commissioner in corroboration of his determinations of the deficiencies involved, as the taxpayers state, but merely for *comparative* purposes as showing the taxpayers' phenomenal increase in wealth far beyond the aggregate net income and increases in net worth disclosed by them in their tax returns filed for the taxable years involved. As against the taxpayers' admitted total

income disclosed in such *certified* statements filed for credit purposes by taxpayer Rose, the Tax Court's redeterminations showed far less net income than did Rose's own statements for the period involved. Moreover, such statements, however adjusted, fail to show the taxpayers' returns to be correct as filed, and in any event they cannot change the result here whereby the Tax Court was obliged to redetermine the taxpayers' taxable net income as best it could in the absence of any accurate accounts and records.

4. The Tax Court, sustaining the Commissioner's determination, properly found upon the evidence that the value of the living quarters in Lori's Villa Courts property occupied rent-free by taxpayers Rose and his wife, was $900 a year during the four taxable years involved here. Lori, though holding that property beneficially for Rose who had an "equity" therein, nevertheless legally owned and operated it while Rose and his wife pre-empted such living quarters without charge. If their free use thereof represented part compensation for Rose's services rendered to Lori during the taxable years, it nevertheless constituted taxable income to him whether or not received in the form of cash. The Tax Court, upon finding that the Commissioner's determination represented the reasonable value of the living quarters in question, was not bound, in the absence of convincing evidence to the contrary, to accept Rose's testimony of a lesser value of the *old* unimproved quarters before it was remodeled and improved into the newly-reconstructed living quarters occupied by taxpayer Rose and wife during the taxable years.

5. (This issue was neither raised nor considered below): The Tax Court properly included in taxpayer Rose's taxable income for 1938 his wife's one-half community share thereof, under the facts here. The record shows that Rose's wife filed no return for that year but that he filed a single return which the Commissioner treated as a joint return, and the Tax Court redetermined the taxpayers' *combined* community net income and tax liability on such basis accordingly. Moreover, so far as the record shows, the tax-

payers made no attempt to file separate returns for that year. Accordingly, under the decisions of this Court, taxpayer Rose is bound by his election to have filed a single return *jointly* for both himself and his wife for that year to the end that no part thereof is now excludible from his income as her community share.

6. The Tax Court correctly found, upon the evidence, that the cost basis of taxpayer Rose's Silver King Coalition Mines stock, sold in 1941, was not in excess of $4,500 which, as determined by the Commissioner, was the maximum allowable at date of acquisition. The taxpayers have established neither the date of acquisition nor the cost of the stock at such date. They claim acquisition in 1936 but the Tax Court found, upon the evidence, that the stock was acquired at some date prior to that year, and the taxpayers have not shown this finding to be wrong. The record shows that it is correct for taxpayer Rose testified that he had acquired the *right*—and consequently the title—to the stock in 1934 but merely did not get physical possession of it until 1936. Accordingly, the Tax Court's redetermination, sustaining the Commissioner's determination, is correct. This alone should be sufficient to deny the taxpayers' contentions. Furthermore, however, the taxpayers have not shown the fair market value of the stock as of the *actual* date of acquisition in 1934. Taxpayer Rose testified that he was unable to obtain the necessary bank records to prove such value at the critical date, and that the value ($9,600) which he used in his 1941 tax return admittedly did not represent the accurate figures but merely *a sort of generalization.* The revenue agent, on the other hand, testified that from the meagre evidence available, he had been unable to determine or verify that taxpayer Rose had paid any amount for the stock in question in excess of $4,500, which was the amount used by the Commissioner in the statutory notice of deficiency for the taxable year involved.

7. The Tax Court properly sustained the Commissioner's determinations disallowing the taxpayers' claimed deductions for depreciation for lack of proof. As to the deprecia-

tion claimed on the Vine Street property by taxpayers Rose and wife, the record shows that the Commissioner allowed them deductions for depreciation therefor to the full extent established for the taxable years involved, and disallowed the remainder. In the absence of further substantiating evidence, the Tax Court had no basis to make further allowances upon redetermination of their community net income for those years. As to Lori's claim for depreciation on its Villa Courts property, the Commissioner disallowed the deductions taken therefor for lack of information establishing the bases upon which allowable depreciation could be determined. The taxpayers have furnished neither the cost bases of the buildings together with or separately from the land, nor any segregation as to what proportion of the aggregate depreciation claimed together by Lori and Brevoort for the Villa Courts and the hotel properties under joint lease, was allocable to the two properties, respectively. Hence, the Commissioner had no permissible bases upon which to determine the depreciation allowable thereon, if any, nor the Tax Court any alternative than to sustain his determination disallowing such depreciation for lack of proof. Moreover, there is no basis in law or the authorities for the taxpayers' novel contention that it was incumbent upon the Tax Court to make allowances for depreciation in their favor even though their evidence was admittedly unsatisfactory.

8. (This issue was not raised below) : The taxpayers have shown no persuasive or authentic reason why Lori, under the facts here, should be an exception to the general rule that the corporate identity should not be disregarded for income tax purposes. The evidence shows that Lori, instead of being a mere title-holder or agent for taxpayer Rose, was a corporation actively engaged in carrying on the business of holding and operating the Villa Courts properties at a profit during the taxable years. It leased its properties during those years, collected the rentals and paid the expenses of operation, borrowed large sums of money from time to time, and did many other things which constituted

corporate activity sufficient to serve a business purpose and to warrant this Court's holding that it was actively engaged in business during the taxable years. Consequently, its corporate identity should not be ignored for tax purposes.

9. The taxpayers have not established that Lori is entitled to the claimed deductions in the sums of $10,748.62 and $6,107.21 for the years 1938 and 1939 for "related expenses" paid on its behalf by taxpayer Rose from his bank accounts out of moneys he received from Lori which, in turn, had received *gross sums* from Brevoort representing *combined* unsegregated rentals received under the joint leases of Brevoort and Lori for the rental of their hotel and Villa Courts property, respectively. These sums were previously allowed taxpayer Rose by the Tax Court as offsets against his income for those years, upon his establishing that he had thereby paid from his bank accounts with moneys received from Lori and/or Brevoort, the current operating expenses of Lori and the hotel to such extent. There is no showing, however, that these amounts were not claimed and allowed in whole or in part as deductions to both Lori and Brevoort. The record shows that most of the items represented expenses of Brevoort's hotel operations, and to the extent which they may be allocable to Lori's Villa Courts properties, the taxpayers have failed to show any segregation of such expenses jointly paid for both such entities. Hence, there is no basis for their allowance by this Court as deductions to Lori. Moreover, there is no showing that the items in question were paid by taxpayer Rose on behalf of Lori, in excess of the amounts substantiated below and therefore conceded by the Commissioner and allowed by the Tax Court. Nor is there any showing, affirmatively, by the taxpayers, other than their own contentions, that the expenses represented by the items in question have not already been allowed in whole or in part by the Tax Court in reaching its redeterminations of Lori's taxable net income for 1938 and 1939.

10. The taxpayers have not established that the amounts claimed as exclusions from Lori's net income for 1939 to

1941, inclusive, represented taxpayer Rose's personal loans deposited in Lori's bank account during those years. Since these items are part of the same transactions in connection with which Rose claimed the exclusion of identical amounts from his taxable income for those years, they should not be excluded from Lori's income for the same reasons—lack of proof—heretofore shown in respect of their non-excludibility from Rose's income for those years. Moreover, the second group of three items is not excludible from Lori's income for the years 1939 to 1941, inclusive, for the taxpayers have not established that they represented merely funds transferred from Rose's bank accounts to Lori's account and not rental receipts from or allocable to Lori's Villa Courts properties. The Tax Court excluded from Lori's taxable income for those years so much of the items in question as the taxpayers were able to establish as representing transfers of personal loan moneys to it from Rose's accounts, understatements of lease receipts properly allocable to the Brevoort hotel and not to Lori's Villa Courts properties, etc., and disallowed the remaining items for lack of proof. So far as the record shows, however, the items in question represented additional rental receipts to Lori, and therefore they may not properly be excluded from its taxable income for the years involved here.

11. (This issue was not raised below): The record shows that Lori has failed to prove that it is entitled to the excess profits credits claimed in the determination of its excess profits tax liability for any of the taxable years involved. This point was raised for the first time in its objections (with alternative computations) filed to the Commissioner's recomputation of its tax liabilities submitted under Tax Court Rule 50 proceedings, pursuant to the Tax Court's opinion entered in this cause. That Rule prescribes the procedure for computing the correct deficiency for entry of the Tax Court's decision, after it has heard and decided all the issues *then* raised and presented on the merits, and requires that the hearing thereon must be confined strictly to a consideration of the correct computation of the defi-

ciency pursuant to the issues already decided, without argument or consideration given to *any new issues*. Hence, since the taxpayers presented no evidence enabling the Tax Court to have made the necessary findings in respect of the essential statutory "excess profits net income", *only* from which the claimed "excess profits credits" were determinable, it is readily apparent that Lori's claim for the excess profits credits can neither be properly raised now nor, if considered here, can it be allowed for lack of proof.

12. The Commissioner determined that the taxpayers were liable for the 50% fraud penalties because their tax returns as filed showed gross understatements and omissions of taxable income for all the taxable years involved. The Tax Court, sustaining the Commissioner's determinations in part, specifically found, *upon the record as a whole*, that the taxpayers' returns were false and fraudulent, and that *any* of the deficiencies asserted for each of the four taxable years was due to fraud with intent to evade taxes. Since the record fully supports these findings and the taxpayers have not shown them to be in any wise erroneous, the fraud penalties were properly imposed as provided by the statute.

ARGUMENT

I

The Tax Court properly found, upon all the evidence, that the taxpayers failed to overcome in large part the *prima facie* correctness of the Commissioner's determination, based upon the net-worth method, of their net income and deficiencies for the taxable years involved.

During all the taxable years involved the taxpayers failed to report large amounts of their taxable net income, as required by the provisions of the applicable taxing Acts. Sections 21(a) and 22(a) of the Internal Revenue Code.[4]

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[4] Since the provisions of the Revenue Act of 1938 and the Internal Revenue Code involved herein are substantially the same, references thereto are, for convenience, to the Code only, unless otherwise specified. See explanations therefor under the statute and the Regulations, respectively, in the Appendix, *infra*.

(Appendix, *infra*). The statute provides that every individual and corporation subject to taxation thereunder shall make the necessary tax returns showing specifically all items of gross income, deductions, credits and such other information as may be necessary for a determination of their net income and tax liability. Sections 41, 42(a), 43, 52(a) and 54(a) of the Internal Revenue Code; Sections 19.41-1, 19.41-3 and 19.54-1 of Treasury Regulations 103 (Appendix, *infra*). The taxpayers failed to comply with these statutory requirements, and therefore the Commissioner asserted appropriate deficiencies against each of them for the taxable years involved. (R. 426-427.) Accordingly, the question presented in respect of each of the taxpayers is whether the Tax Court properly found, upon all the evidence, that they failed, in large part, to overcome the presumptive correctness of the Commissioner's determination that the amounts of their taxable income realized for the years 1938 to 1941, inclusive, were, on the basis of the increases ascertained in their net worth, not less than the sums upon which the respective deficiencies were computed. Determinative of the issue, generally, is the decision as to the *ownership* of the income in question. This, in turn, depends upon the correctness of the Commissioner's determinations—as redetermined by the Tax Court—that in the absence of any adequate books or records kept by the taxpayers, and based upon his reconstruction of their bank deposits as well as other evidence of their receipt of income, large amounts of unreported income were realized by the several taxpayers to the extent of the unexplained deposits in their various bank accounts during each of the taxable years involved.

As to the ownership of the income in question, it will be noted that one outstanding fact implicit in the entire record is that substantially all the income of Lori, Brevoort and the other corporate enterprises herein inured to taxpayer Rose's benefit individually, not only during the four taxable years but also thereafter. (R. 431-432, 435-436, 441-447.) It is noteworthy, moreover, as the Tax Court found (R. 450), that instead of refuting the Commissioner's de-

terminations in large part, the best the taxpayers were able to do—and this in their reply brief (Tr. 30)—was to conclude that as to each of them for each of the taxable years, they admittedly could not identify or explain substantial amounts of the deposits in the various bank accounts. Nevertheless, they contended, incongruously, that since most of their funds received during the taxable years were paid out indiscriminately without regard to the nature of the expenditures or segregation as to amounts and entities in so far as income tax deductions were concerned (R. 434, 436, 445, 447, 449), the amounts of their taxable income were no greater than those reported for each year. They insist, moreover, that their "returns were correct, or fairly so", as filed for each of the taxable years (Br. 21); and they contend that because of the numerous gross errors in the Commissioner's determinations as conceded by him —upon the taxpayers' adducing additional evidence—in the Tax Court (R. 440-446), and as found by the Tax Court—upon their furnishing still further evidence—in respect of previously unexplained items (R. 441, 447), as well as those pointed out by the taxpayers here (Br. 4-5), the presumptive correctness of the Commissioner's determinations was thereby overcome, and it was therefore incumbent upon the Tax Court, without more, to have *itself* redetermined their taxable net incomes for all years independently of the Commissioner's determinations (Br. 37-39). There is no basis in the record for these contentions.

The Tax Court found, on the basis of the entire record, that except for the items which they were able to prove as not clearly representing realized income and the amounts which they established themselves entitled to as proper deductions (R. 440-441, 446-447), the taxpayers, upon whom rested the burden of proving error, failed to show that the amounts in question, as redetermined by it, were erroneous. Consequently, with the exceptions mentioned, it affirmed all the deficiencies in controversy. (R. 449-451.) The Tax Court's findings to such effect are abundantly supported by the record. The Tax Court found that the taxpayers admittedly failed to keep any books or accurate records of

their income and expenditures for the taxable years, or any other documents adequately reflecting such information from which their correct income could be ascertained by the Commissioner (R. 434, 436, 445, 449-450), even though they were required by law to do so. Sections 41, 42 (a), 43, 52 (a) and 54 (a) of the Internal Revenue Code; Sections 19.41-1, 19.41-3, 19.43-2, and 19.54-1 of Treasury Regulations 103 (Appendix, *infra*). *Halle* v. *Commissioner,* 175 F. 2d 500, 502-503 (C.A. 2d), certiorari denied, 338 U.S. 949. In *Spies* v. *United States,* 317 U.S. 492, the Supreme Court stated that (p. 495):

> The United States has relied for the collection of its income tax largely upon the taxpayer's own disclosures * * *. This system can function successfully only if those within and near taxable income keep and render true accounts.

But if the taxpayers "kept no books disclosing income and expenses * * * this can not be used as an excuse to escape the payment of income tax." *United States* v. *Zimmerman,* 108 F. 2d 370, 373 (C.A. 7th); *Roberts* v. *Commissioner,* 176 F. 2d 221 (C.A. 9th); *United States* v. *Hornstein,* 176 F. 2d 217, 220 (C.A. 7th). Accordingly, this is a case where the Commissioner and the Tax Court were compelled to ascertain and determine the taxpayer's taxable income as best they could from other evidence. In the absence of substantially *any* adequate records, the Commissioner had full authority to compute their income and determine their tax liabilities from whatever information and data he could find "in accordance with such method as in the opinion of the Commissioner does clearly reflect the income." Section 41, Internal Revenue Code; Section 19.41-1, Treasury Regulations 103.

Moreover, contrary to the taxpayers' contentions (Br. 37-39), the Commissioner's determinations were *prima facie* correct, and the burden of proving them wrong and that the amounts of their *true* income were less than those which were taxed, was on the taxpayers. *Helvering* v. *Gowran,* 302 U.S. 238, 246; *Welch* v. *Helvering,* 290 U.S. 111, 115; *Phillips* v. *Dime Trust & S. D. Co.,* 284 U.S. 160, 167; *San*

Joaquin Brick Co. v. *Commissioner,* 130 F. 2d 220, 225 (C.A. 9th); *Hirsch* v. *Commissioner,* 124 F. 2d 24, 28 (C.A. 9th); *Carmack* v. *Commissioner,* 183 F. 2d 1, 2 (C.A. 5th), certiorari denied, 340 U.S. 875. Furthermore, the Tax Court's findings and conclusions—to the extent sustaining the Commissioner's determinations—are entitled to finality where, as here, they are supported by substantial evidence and are not shown to be "clearly erroneous". Rule 52 (a), Federal Rules of Civil Procedure;[5] *United States* v. *Gypsum Co.,* 333 U.S. 364, 394-395, rehearing denied, 333 U.S. 869; *Joe Balestrieri & Co.* v. *Commissioner,* 177 F. 2d 867, 873 (C.A. 9th); *Grace Bros.* v. *Commissioner,* 173 F. 2d 170 (C.A. 9th). Quite plainly, the taxpayers, upon this record, have not met the burden of showing that the Commissioner's determination, as redetermined by the Tax Court, or the Tax Court's findings, were wrong.

In many cases where taxpayers, engaged in business, have failed to keep proper books of accounts and records of income-producing transactions, the courts have sustained the Commissioner's determinations of income upon the basis of the increase in the taxpayer's net worth for each year under review, and adding thereto a reasonable estimated amount, not reflected in such increase, to cover personal and living expenses. *Roberts* v. *Commissioner,* 176 F. 2d 221, 226 (C.A. 9th); *Carmack* v. *Commissioner,* 183 F. 2d 1 (C.A. 5th), certiorari denied, 340 U.S. 875; *Burka* v. *Commissioner,* 179 F. 2d 483, 484-485 (C.A. 4th); *Halle* v. *Commissioner,* 175 F. 2d 500, 503 (C.A. 2d), certiorari denied, 338 U.S. 949; *Mazzacone* v. *Commissioner,* decided May 20, 1948 (1948 P-H T.C. Memorandum Decisions, par. 48,084), affirmed *per curiam,* 175 F. 2d 778 (C.A. 3d); *Harris* v. *Commissioner,* 174 F. 2d 70 (C.A. 4th); *Stinnett* v. *United States,* 173 F. 2d 129 (C.A. 4th),

[5] Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948, c. 646, 62 Stat. 869, 991, provides that the Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court in the same manner and to the same extent as decisions of the District Courts in civil actions tried without a jury.

certiorari denied, 337 U.S. 957; *Jelaza* v. *United States,* 179 F. 2d 202, 203 (C.A. 4th); *Kenney* v. *Commissioner,* 111 F. 2d 374, 375 (C.A. 5th); *Hoefle* v. *Commissioner,* 114 F. 2d 713, 714 (C.A. 6th); *Brodella* v. *United States,* 184 F. 2d 823, 824-825 (C.A. 6th); *Hague Estate* v. *Commissioner,* 132 F. 2d 775, 777-778 (C.A. 2d), certiorari denied, 318 U.S. 787.

In *Roberts* v. *Commissioner,* 176 F. 2d 221, this Court held (p. 226) that:

> The Tax Court was, therefore, right in sustaining the determination of the Commissioner. They were also correct in sustaining his determination as to the amount of the deficiency. *The petitioner had kept no books.* So the Tax Court had to determine the amount from such evidence as was presented to them. *If the result is an approximation, the lack of exactitude is traceable to the petitioner's own failure to keep accurate accounts.* [Italics supplied.]

To the same effect, see *Carmack* v. *Commissioner, supra,* p. 2; *Halle* v. *Commissioner, supra,* p. 503; and *Kenney* v. *Commissioner, supra,* p. 375.

Not only did the taxpayers fail to keep proper records as required by law, but also they afforded the Commissioner a minimum of cooperation during his protracted investigation of their tax returns for the four years involved. (R. 34-39, 400-403, 409-414, 436, 449.) In the absence of such records and assistance, however, the Commissioner determined the net worth of each of the taxpayers as of the beginning and end of each taxable year. (R. 436-440, 445; Exs. N, O and P.) [6] He accomplished

[6] All of the exhibits herein (Pet. Exs. 1 to 97, inclusive, and Resp. Exs. A to Z, and AA to JJ, both inclusive (Tr. 12)) were omitted from the printed record, as too bulky and costly to print, by order of this Court entered on June 29, 1950, pursuant to the taxpayers' motion, but they may nevertheless be referred to by the parties in briefing and argument of the cause (R. 565-567). While the taxpayers designated for printing specified portions of respondent's Exhibits R and S, and also of the petitioners' Exhibits 12 and 94 (R. 562-563), they do not appear to have been

this by reconstructing their various total bank deposits, less proper eliminations and cancelled checks showing allowable deductions (R. 405, 440, 445), together with other fragmentary evidence indicating the receipt of income and disbursement of substantial expenses, thereby arriving at their taxable income and deficiencies asserted for each of the four years involved (R. 33-81, 364-407, 436-442, 445-447). The resulting amounts of net income thus ascertained were based upon the determination that all unidentified and unexplained bank deposits represented taxable receipts, the payments made by taxpayer Rose to the Brevoort hotel operating company represented loans to that company for operating expenses, and that the personal and business expenses paid by him by means of checks written on Lori's bank account constituted constructive payments of dividends and distributions taxable to him to the extent that they were not otherwise explained. (R. 397-400, 436-440, 445; Exs. N, O and P.) The Commissioner was fully justified in doing this in order to determine the taxpayers' true income under his statutory authority to prevent evasion of taxes by closely allied taxable entities' arbitrarily shifting income and expense to suit their own purposes. Section 45, Internal Revenue Code (Appendix, *infra*).

Moreover, at the hearing below the taxpayers offered no satisfactory explanation for their failure to have kept proper records showing the segregation of items of receipts and disbursements of the several entities for the taxable years. (R. 449.) Nor did they make any successful effort to refute in large part, the presumptive correctness of the Commissioner's determinations of their net worth and the resulting net income and deficiencies for those years (R. 450), except to the extent conceded by the Commissioner and allowed by the Tax Court upon their furnishing addi-

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included in the printed record. Since all the petitioners' exhibits are numbered and the respondent's lettered, the usual prefixal designations "Pet." and "Resp." have been omitted in references thereto.

tional evidence, as shown hereinafter. Such new evidence (including many exhibits), though unsatisfactory and contradictory, enabled the Tax Court to redetermine, to a degree, the proper figures and bases for the computation of the taxpayers' net income for the several years involved as nearly as possible from the meagre evidence and data then made available. (R. 440-444, 446-447, 449-450.)

As to the community net income of the individual taxpayers, Rose and his wife, the Commissioner subtracted from the increases in their net worth ascertained for each year all the allowable identified deductions, as business expenses, transfers between the various bank accounts, charge-back by the banks, divers and sundry payments to others, etc. He added thereto amounts considered reasonably sufficient to cover the taxpayers' personal, living and family expenses, not otherwise reflected in the computations. Section 24 (a) (1), Internal Revenue Code (Appendix, *infra*). He thereby, upon appropriate adjustments made, arrived at their community net income and the resulting deficiencies asserted for each year. (R. 397-400, 436-440, 442-443, 449-450; Ex. N.) In so doing, "No reasonable doubts were resolved against the taxpayer, while the audit and analysis made by the Commissioner seems to have been made as accurate as the circumstances here permitted." *Halle* v. *Commissioner,* 175 F. 2d 500, 502-503 (C.A. 2d), certiorari denied, 338 U.S. 949. It is significant, moreover, that the increases in the taxpayers' individual net worth and their total community net income as thus determined by the Commissioner for the taxable years, while substantial, were far less than those shown by taxpayer Rose himself in his annual statements of financial condition, submitted to his bank for credit purposes, covering substantially the same period involved here. (R. 444, 450-451; Ex. S; Pet. Br. 15-21.)[7] As to the corporate taxpayer, Lori, the Commissioner, in the absence of any adequate records, determined that the amounts of the gross deposits, neither identified nor ex-

[7] See also Point III, *infra.*

plained, in its bank account, less all deductions substantiated by cancelled checks written by Lori and other fragmentary evidence, represented taxable net income for which it was chargeable for the taxable years involved. (R. 445, 470-479.)

As to all the taxpayers, individual and corporate, upon their adducing for the first time at the hearing below additional evidence identifying more cancelled checks and furnishing other data not theretofore made available, the Commissioner recognized and conceded that the amounts of their net income, as originally determined, had been overstated for the years 1938 and 1939 in the total sums of $7,375 for taxpayers Rose and wife, and $22,192.90 for taxpayer Lori, respectively. (R. 440-441, 446.) In addition to such concessions by the Commissioner, moreover, the Tax Court found that the taxpayers had established by further new evidence that they were entitled to additional adjustments representing items theretofore unidentified and unexplained whereby the amounts of their net income, as previously determined by the Commissioner, were still further decreased by the aggregate sum of $30,130.07 for taxpayers Rose and wife for all the taxable years, and by the total sum of $19,986.24 for Lori for the years 1938, 1940 and 1941. (R. 440-441, 447, 450.) Full effect was thereupon given to all these concessions, adjustments and allowances—decreasing the taxpayers' income in the aggregate sums of $37,505.07 and $42,179.14 for taxpayers Rose and wife, and for Lori, respectively—in the Commissioner's recomputations submitted under Tax Court Rule 50,[8] which resulted in overassessments of tax liabilities abated for each of the taxpayers for all taxable years involved. (Tr. 35, 61, 71, 81.)

These adjustments represented the *maximum* allowances possible by the Tax Court under *all* of the additional data

[8] Rule 50 of the Rules of Practice before the Tax Court of the United States prescribes the procedure for computing the amount of the deficiency after the Tax Court has heard and decided all the issues raised and presented on the merits. *Bankers Coal Co.* v. *Burnet,* 287 U. S. 308.

and contradictory evidence adduced by the taxpayers. (R. 440-441, 446-447, 449-450.) The Tax Court found that they were necessary the more clearly to reflect the community net income of taxpayers Rose and wife in respect of the many transactions, identified and explained, involving Rose's deposits, withdrawals and checks written on Lori's bank account, as well as the taxable net income of Lori in respect of the many deposits made to its credit comprising funds properly accountable by and chargeable to others which did not represent income to Lori. (R. 450.) The remaining items which could not be explained by the taxpayers, however, were, for lack of proof, treated by the Tax Court as taxable income to them to the end that they were charged with only the *net* amounts to the extent unidentified or otherwise unexplained. (R. 440-441, 446-447.) *Helvering* v. *Bruun,* 309 U.S. 461, 467-468; *Helvering* v. *Taylor,* 293 U.S. 507, 514-515; *Burnet* v. *Houston,* 283 U.S. 223, 227-228; *Halle v. Commissioner, supra,* p. 503; *Christman Co.* v. *Commissioner,* 166 F. 2d 1016 (C.A. 6th). Notwithstanding these many liberal allowances on the basis of fragmentary and questionable evidence (R. 449-450), however, the taxpayers now complain of many additional items allegedly adjusted or disallowed improperly by the Tax Court (Br. 4-5, 10-37). (These are dealt with hereinafter, seriatim, under Points II-VII in respect of taxpayers Rose and wife, and Points VII-XI in respect of Lori.)

II

The Tax Court, for lack of proof, properly sustained the Commissioner's determination including the sums of $10,000, $1,456.76 and $7,005.32 in taxpayer Rose's gross income for the years 1939, 1940 and 1941, respectively.

Taxpayer Rose contends (Br. 10-14) that the Tax Court erroneously failed to eliminate from his gross income, as determined by the Commissioner from the total dividends, gains and profits which he received from Lori during the taxable years 1939, 1940 and 1941 (R. 439), the respective sums of $10,000, $1,456.76 and $7,005.32 allegedly repre-

senting Rose's borrowed moneys deposited in Lori's bank account during those years, the last amount including his salary of $1,200 received from Lori in 1941 which he reported as income for that year. While he does not dispute the item of $15,873.23 thus included in his income by the Commissioner and sustained by the Tax Court for 1938 (Pet. Br. 10, 14), he does claim that disbursements Lori made to him or for his account during 1939-1941 should be offset by the above sums, respectively, as allegedly representing his borrowed moneys even though deposited in Lori's account (Br. 12-14).

In so far as the record shows, the Tax Court had no basis whatever for making any additional adjustments for these unsubstantiated items. Their inclusion in the Commissioner's deficiency notices as income representing payments made by Lori to Rose for his personal purposes and benefit or as items unexplained, to the extent redetermined by the Tax Court, was not shown by the taxpayers to be wrong. (R. 439-442, 446-447, 449-450.)

It will be noted that all the items complained of—except the 1939 legal fee of $6,500, and the 1941 salary of $1,200—are claimed to have represented moneys borrowed by Rose individually and, for reasons undisclosed, deposited in Lori's bank account during 1939, 1940 and 1941 (Exs. R and 15), and therefore not chargeable to him (Br. 12-13). While the record indicates that Rose borrowed such sums and that like (or adjusted) amounts were concurrently deposited in Lori's account, there is no showing that they did not represent taxable transactions, that he did not owe Lori such amounts, or that upon depositing them in Lori's account he did not thereafter continue to draw checks in smaller amounts against such total deposits for his own purposes until the full amounts thereof were exhausted. The evidence shows that he did so continuously in connection with other equally unexplained transactions during the taxable years, both before and after the dates of the above deposits (R. 405-407, 431, 434, 435, 447; Exs. 12, 94,

95, R),[9] and there is no showing whatever that he did not do so in respect of the several items here in question. That he did so in the case of the first item, $2,000, borrowed and a like amount deposited in Lori's account on September 1, 1939 (Pet. Br. 12), for example, is shown by the fact that the final payment of interest ($23.83) on such "loan" was made by check dated December 7, 1939, drawn by Rose *on Lori's account* for such amount (Ex. 12, p. 16, *et seq.*; Exs. 94, 95; Ex. R, pp. D-4 and D-5). As the record shows, Rose drew countless other checks on Lori's account for unexplained payments against equally unidentified deposits in Lori's account from time to time, as well as for large cash withdrawals therefrom for many of his own undisclosed purposes during the taxable years. (R. 434, 435, 445, 447; Exs. 12, 94, 95, R.) He furnishes no proof, however, that this was not done in respect of the several items here, nor any evidence whereby the many like or similar transactions, before and after the above deposits in Lori's account, can be traced or identified in respect to the "loans" and deposits here in question or otherwise. Nor can he, apparently, furnish such proof for the record shows that his personal and business funds and expenditures were inextricably intermingled with those of Lori and his other corporate enterprises from year to year, without any adequate records showing segregation of receipts and disbursements of the various taxable entities. (R. 431, 434-435, 441, 445, 447, 449-450.) In any event, taxpayer Rose has made no successful effort to establish affirmatively, other than by his own statements,

[9] Exhibit 94 comprises large bundles of cancelled checks and miscellaneous charge slips purported by the taxpayers to show all payments made by Lori during the years 1939 to 1941, inclusive. (R. 293; Tr. 23, Schedule A, Part I, pp. 5-6.) Exhibit 95, supplementing Exhibit 94, constitutes the check book records of Lori containing check stubs and tabs purportedly showing Lori's total disbursements as listed thereon for the years 1937 to 1941, inclusive, and allegedly explaining all the checks missing from Exhibit 94, beginning with January 1, 1938. (R. 293-296; Tr. 23, Schedule A, Part I, p. 7.)

that the items in question have not already been allowed in whole or in part by the Commissioner and the Tax Court in reaching their determinations of his net income for the years 1939, 1940 and 1941. (R. 440-441; Tr. 35, 81.)

Moreover, the record shows that the legal fee complained of as improperly included in the sum of $6,500 in Rose's 1939 income (Pet. Br. 12, 14), represented part of the $17,500 total fee he received in 1939, of which he deposited $6,500 in Lori's account in that year (R. 442, 446; Ex. 12, p. 15). Since the latter amount was neither deposited in any of his own various bank accounts (R. 442, 446) nor reported in his tax return for 1939 (Ex. F), he was properly charged therewith by the Commissioner and the Tax Court as taxable income for that year (R. 438, 527-528; Tr. 81, pp. 2-4). Finally, as to the remaining item, $1,200, representing salary for 1941, Rose claims (Br. 13-14) a reduction in his gross income therefor on the ground that he received such amount from Lori and reported it in his 1941 return (Ex. G), but that the Commissioner allegedly failed to subtract it from his taxable income returned for that year (R. 529-531). While Rose did report such amount—which "Lori paid me as a retainer" (R. 400)—as part of his total net income of $14,495.10 disclosed in his 1941 return (Ex. G; R. 529), nevertheless the record shows that the Commissioner used the latter amount (which included the $1,200) as his starting point in making his determination of deficiency for that year (R. 529), and made allowance therefor as a reduction from 1941 income as "* * * salary from Lori assumed to be in deposits" (R. 438, 399-400; Ex. N). Hence, the $1,200 item was properly excluded from Rose's 1941 taxable income as redetermined by the Tax Court for that year, pursuant to the Commissioner's recomputation under Rule 50 of the Tax Court submitted for entry of the Tax Court's decision for that year. (R. 446-447, 450, 529-531; Tr. 81, pp. 4-5.) Accordingly, full allowance has already been made for both of these items.

In these circumstances, it is quite plain that the Tax Court, in the absence of any showing that the foregoing

unexplained deposits represented mere repayment of Rose's personal loans previously made to Lori or other nontaxable transactions, as claimed, was obliged to treat them as taxable receipts and payments to Rose in so far as determined to be income in the deficiency notices. (R. 439; Pet. Br. 10-11.) This is no different from the endless other transactions involving checks and withdrawals for personal and business expenses—other than Lori's (R. 431, 447)—drawn by Rose on Lori's account which the Commissioner and the Tax Court were obliged, for lack of proof, to treat as constructive dividends and taxable distributions from Lori to Rose, to the extent not otherwise identified or explained (R. 397-400, 436-442, 446-447; Ex. N). Section 22 (e) of the Internal Revenue Code; Sections 19.22 (a)-1, 19.22 (a)-3 and 19.41-1 of Treasury Regulations 103 (Appendix, *infra*). Hence, the Tax Court treated such unexplained items as taxable income to Rose for the evidence in respect of the plethora of transactions and transfers between him, particularly, and the various other individuals and entities is so hopelessly confused that it is impossible—as this Court will find—to make any clear ascertainment and determination upon this record for the further allowances now claimed as offsetting items against the transfers from Lori to Rose. There is no *reliable* evidence in the record by which those transactions can be identified, traced, collated or related one with another. One thing is certain—the evidence in respect of most of Rose's loans as well as other transactions for *all* years is wholly insufficient to identify the many deposits made in his own accounts and/or in Lori's account, in amounts greater than those allowed by the Commissioner and the Tax Court. Consequently, to the extent that Rose deposited his "loans" in Lori's bank account, and retained the many receipts from Lori (as well as from his other enterprises) in his own bank accounts, without explaining or accounting therefor to anyone, much less the taxing authorities (R. 431, 435, 447, 516-517), it is clear that the Commissioner and in turn the Tax Court had no alternative than to treat them

as taxable income for lack of proof to the contrary[10] (R. 430-431, 434, 435, 445, 447). Hence, this contention must fail. *Interstate Transit Lines* v. *Commissioner,* 319 U.S. 590, 593; *Helvering* v. *Bruun,* 309 U.S. 461, 467-468; *Roberts* v. *Commissioner,* 176 F.2d 221, 226 (C.A. 9th); *San Joaquin Brick Co.* v. *Commissioner,* 130 F.2d 220, 225 (C.A. 9th).

III

Taxpayer Rose's financial statements, adjusted to the cash basis upon which the taxpayers' returns were filed, do not establish their returns to be correct as filed.

The taxpayers contend further that the Commissioner's own evidence introduced for the purpose of "corroborating" his computations of their increases in net worth and taxable community net income based on bank deposits and disbursements, confirms the accuracy of their returns as filed for the four taxable years involved. (Br. 15-21.) The documents referred to comprised four statements of Rose's financial condition, covering substantially the same quadrennial period as here, which he submitted to his bank for credit purposes. (R. 444, 450-451; Ex. S; Pet. Br. 15-21.) The taxpayers state that these statements, adjusted to the cash basis in harmony with their tax returns filed on such basis, show a total net income of only approximately $41,000 "on the basis of income data" (Br. 21), whereas they reported total community net income of $37,706.61 for the four-year period involved (Br. 16-21).

First, this issue was neither alleged in the taxpayers' petitions for redetermination of the deficiencies involved (R. 7-10, 498-505, 513-524), nor was it presented to or con-

[10] The taxpayers also contend (Br. 27-28) that five of the identical items—$2,000, $1,500, $1,456.76, $1,700 and $1,500, totaling $8,156.76 for the years 1939-1941—claimed here as excludible from Rose's income (Br. 12-14), should also be excluded from Lori's taxable income for those years, the allowance of which, of course, would permit all the taxpayers to avoid taxation thereon, even though not established as excludible from taxable income. This is dealt with hereinafter under Point X, in respect of Lori.

sidered by the Tax Court (R. 426-455). Neither was it assigned as error (R. 544-546), nor included in the taxpayers' statement of points intended to be relied on upon review (R. 549-560). Consequently, this Court is not called upon to decide the issue but, under the authorities, is duty bound to pass it. *Helvering* v. *Salvage,* 297 U.S. 106; *General Utilities Co.* v. *Helvering,* 296 U.S. 200, 206; *Harvey* v. *Commissioner,* 171 F.2d 952, 955 (C.A. 9th); *Popular Priced T. Co.* v. *Commissioner,* 33 F.2d 464 (C.A. 7th); *Hanby* v. *Commissioner,* 67 F.2d 125 (C.A. 4th).

Next, if this Court should nevertheless decide to consider the issue, we submit the following: Contrary to the taxpayers' contention that the statements in question were adduced in evidence by the Commissioner *in corroboration* of his determinations of their increases in net worth, the fact is, of course, that they were introduced merely for *comparative* purposes as showing the taxpayers' phenominal increase in wealth (R. 444, 450-451; Ex. S, pp. A-3 and A-9), far beyond the aggregate income disclosed by taxpayer Rose and wife in their tax returns (Exs. E-J), as well as that redetermined by the Tax Court (Pet. Br. 20). The statements disclose an aggregate increase in taxpayer Rose's net worth of $75,000 and total income of $85,300 for the four-year period involved, and they were certified by taxpayer Rose "as being a full, true and correct statement of * * * [his] financial condition on the date given", and "to be true and correct to the best of my knowledge and belief." [11] (Ex. S, pp. A-3 to A-9; R. 444.) As against such admitted total income, the Tax Court redetermined the community net income of taxpayers Rose and wife to be only the total sum of $79,540.06 for the

[11] It must be assumed, we submit, that taxpayer Rose's certified statements submitted to his own bank from year to year represented his *true* financial condition for the four-year period involved for, as the Tax Court pointed out (R. 450-451), the falsification of such statements constitutes a crime under California law. See Section 532 ("False Pretenses", etc.) and Section 532a ("False Financial Statements", etc.) of Deering's Penal Code of California (1949).

entire four years involved (R. 455-456, 512-513, 541; Pet. Br. 20). The taxpayers, however, departing from Rose's *certified* statements currently submitted to his bank during those years, reported only $37,706.61 as their entire community net income for such period, a difference in excess of $47,500 from that shown by the statements (Pet. Br. 20-21).

The taxpayers state (Br. 15-17) that these financial statements merely represented income earned and accrued but not *received,* and therefore not cash-basis income such as they reported; and upon being adjusted to such basis by eliminating the accounts receivable, they disclose substantially the same income as reported in their returns (Exs. E-J; Br. 19-21)—which they insist were correct or nearly so, as filed (Br. 21). This is not borne out by the record. Thus, the last of Rose's financial statements coming within the four-year taxable period involved here was the third one which he submitted to his bank on March 1, 1940. (R. 444; Pet. Br. 20.) Hence, that statement showing accounts receivable (less accounts payable of $3,750) in the *net* sum of $31,250, is evidence only of the receivables on that date but plainly not for the rest of the year 1940. Moreover, *no* accounts receivable are shown for the last taxable year (1941) involved here. (R. 444; Ex. S, p. A-7.) Quite plainly, therefore, the last statement Rose submitted to his bank on September 21, 1942, disclosing accounts receivable of $50,000 *on that date,* does not establish or show *any* accounts receivable for the last taxable year involved here. (R. 444; Ex. S, p. A-9; Pet. Br. 15-21.) Even if adjustment of that statement to the cash basis would make any difference tax-wise, there is no such statement in evidence covering the last taxable year and, consequently, the record showing nothing to the contrary, the Tax Court's redetermination must stand as correct. Hence, in so far as the record shows, the taxpayers' returns grossly understating their taxable net income by more than $41,800 (Br. 20), must necessarily be incorrect to such extent at least. In any event, the taxpayers' adjusting such statements to the cash basis in an attempt to establish the purported correct-

ness of their returns as filed (Br. 15-21), is not only futile but cannot change the result here. In these circumstances, it must be apparent even to the taxpayers that neither the Commissioner nor the Tax Court used the statements in question, other than comparatively, in the determination, on the net-worth basis, of their community net income for the taxable years involved.

IV

The Tax Court properly included in the community net income of taxpayers Rose and wife the value of their living quarters received rent-free from Lori during the taxable years.

The taxpayers contend (Br. 33) that since the Tax Court treated Rose as the beneficial owner of the Villa Courts property, it improperly included in his and his wife's community net income the rental value of their living quarters which they received rent-free from Lori during the taxable years 1938 to 1941, inclusive (R. 439, 442-443).

The record shows, however, that although the property was held by Lori beneficially for Rose (R. 433, 435-436), it was nevertheless legally owned and operated by Lori, just as several other properties were held and operated by other entities for his beneficial interest in order to accomplish his individual purposes (R. 56-57, 337, 432-436). Although Rose *assumed* the rights of ownership to Lori's property (as well as other properties) practically from the beginning, the evidence does not establish that he had acquired full title thereto until nearly the end of the last taxable year involved here—November 24, 1941—when by virtue of the contract whereby he, having already appropriated most of her assets, guaranteed Mary Allen an annuity of $200 a month for life, he obtained the interest theretofore owned by her. (R. 318, 327-328, 432-436; Ex. HH.) Lori, therefore, as the real owner of the Villa Courts property, received and accounted for *its* one-third share, and the Brevoort hotel properties for its two-thirds share, of the total rentals realized by them from the joint leasing of the Villa Courts and the hotel, respectively. (R. 435-

436, 441, 446-447; Ex. 89.) The record shows that Rose *himself* considered that he had merely an "equity" in the Villa Courts property owned by Lori during the taxable years. (Ex. S, pp. A-7 and A-9; Pet. Br. 19, 22.) Since the evidence shows, however, that he had "sole control" over Lori at all times material here (R. 428), it is quite clear that Lori, though a corporation currently operating its Villa Courts property (R. 350, 441, 446-447), was in no position to exact its rightful rentals from Rose even though, as owner, it was chargeable for income tax purposes with the income from the property (R. 432, 433, 435-436; Exs. A-D). Consequently, the value of any free use of Lori's property pre-empted by taxpayers Rose and wife as living quarters constituted taxable income to them. Section 22 (a), Internal Revenue Code; Section 19.22 (a)-3, Treasury Regulations 103. Cf. *Chandler* v. *Commissioner,* 119 F.2d 623, 626-628 (C.A. 3d); *Kitchen* v. *Commissioner,* 11 B.T.A. 855; *Dean* v. *Commissioner,* 9 T.C. 256. If the free use of the living quarters represented part compensation for Rose's services rendered to Lori during the taxable years—for which he testified (R. 349) he felt that he was "entitled to collect as a fee"—it nevertheless constituted taxable income to him. Section 19.22(a)-3, Treasury Regulations 103. It was not necessary that it be paid in the form of cash to have constituted taxable income. Section 19.41-1, Treasury Regulations 103. Moreover, had the taxpayers not thus appropriated the living quarters without charge, it is not unreasonable to suppose that, the acute housing shortage considered, Lori would have received the equivalent of their unpaid rent, or more, from other tenants. *Commissioner* v. *Plant,* 76 F.2d 8 (C.A. 2d), relied on by the taxpayers (Br. 33) is distinguishable. There the court held merely that the beneficiary was not taxable on the nondistributable income of the trust used to maintain a residence for him, pursuant to the directions in the testator's will. That is not the situation here.

The only evidence bearing on this issue is Rose's own testimony that such quarters, formerly an "old" gym-

nasium and laundry which he estimated had a rental value of approximately $30 a month, had been changed into the "Penthouse Villa" occupied by him and his wife without paying rent during the taxable years. (R. 303-304.) The Commissioner determined that such quarters represented value to the taxpayers of at least $75 a month, or $900 a year. (R. 15, 439; Ex. N.) While taxpayer Rose's testimony does not comport with the Commissioner's determination of the current reasonable rental value of like or similar living quarters in that area during the period involved, nevertheless the taxpayers offered no evidence with respect to other like or comparable apartments or living units in or near the Villa Courts property. The Tax Court was not bound to accept Rose's testimony in respect of the rental value of *old* unimproved quarters (R. 303), as being equivalent to that of newly-constructed living quarters. *Elmhurst Cemetery Co.* v. *Commissioner,* 300 U.S. 37, 40; *Joe Balestrieri & Co.* v. *Commissioner,* 177 F.2d 867, 873 (C.A. 9th). Hence, in the absence of any substantial evidence to the contrary, the Tax Court was warranted in finding, upon all the evidence, that the value of such living quarters was $900 a year for each of the four years involved. (R. 442-443.) *United States* v. *Yellow Cab Co.,* 338 U.S. 338, 340-342; *Ruud* v. *American Packing & Provision Co.,* 177 F.2d 538, 540 (C.A. 9th). Accordingly, it is clear that there is no basis for the taxpayers' contention (Br. 33) that the rental value of the living quarters occupied by them without charge, is not includible in their taxable community net income. *Chandler* v. *Commissioner,* 119 F.2d 623, 626-628 (C.A. 3d).

V

The Tax Court correctly included in taxpayer Rose's taxable income for 1938 his wife's one-half community share thereof.

The taxpayers contend (Br. 34-35) that since Rose's income for 1938 was wholly community income, the Tax Court erred in including his wife's one-half community share of his earned income in his gross income for that year. The record shows that this issue was not raised below (R. 514-

518, 524), nor was it considered by the Tax Court (R. 426-455; Tr. 81). The Tax Court, therefore, had no opportunity to pass on it. Consequently, this Court should pass the point. *Helvering* v. *Salvage,* 297 U. S. 106; *General Utilities Co.* v. *Helvering,* 296 U. S. 200, 206-207; *Harvey* v. *Commissioner,* 171 F. 2d 952, 955 (C.A. 9th). If this Court nevertheless decides to consider the point, the following is submitted:

The record shows that taxpayer Rose filed his return for 1938 disclosing no income or tax liability (R. 429, 526; Ex. E), and the Commissioner determined his total net income in the sum of $26,374.72, of which $8,172.55 represented his professional income (R. 440, 526-527). The Tax Court redetermined his total net income for that year to be $8,203.21, the portion thereof representing professional income not appearing separately in the Commissioner's recomputation made pursuant to the Tax Court's decision. (Tr. 81.) The taxpayers insist that this was error because only one-half of Rose's professionally earned income ($8,172.55) is taxable to him, and that therefore the remainder, being taxable as community net income to his wife who is not involved here, must be excluded from his income. (Br. 34-35.)

The rule that spouses domiciled in a State having the community property system of ownership of marital property may report one-half of the community income in separate returns, is not expressly stated in the taxing statute or the Regulations. It is nevertheless firmly established otherwise that they *may* thus divide and report their incomes and tax liabilities separately. Mim. 3853, X-1 Cum. Bull. 139 (1931); *Poe* v. *Seaborn,* 282 U.S. 101; *United States* v. *Malcolm,* 282 U.S. 792; *Black* v. *Commissioner,* 114 F. 2d 355, 358 (C.A. 9th). Where a single return is filed not on the community property basis, there is no showing of real intent on the part of the spouses to have filed on such basis, the total incomes have not been separated and the tax has been computed on the *combined* net community income, the return is taxable as a joint return, in the

absence of evidence clearly indicating an intention to have filed on the community basis, as here. I.T. 1530, I-2 Cum. Bull. 174 (1922). In these circumstances, since taxpayer Rose filed a single return without claiming any division of community income for 1938, which the Commissioner treated as a joint return (R. 58-59), and upon which the Tax Court redetermined the taxpayers' correct combined community net income and tax liability to the extent of the evidence available (R. 429; Tr. 81; Ex. E), the wife filed no return, and in so far as the record shows they made no attempt to file separate returns for 1938 (Br. 34-35), taxpayer Rose is bound by his election to have filed "a single return made by them jointly" for both himself and his wife for that year. Section 51 (b), Revenue Act of 1938 (Appendix, *infra*). See *Commissioner* v. *Harmon,* 323 U.S. 44; *Poe* v. *Seaborn, supra; Binder* v. *Welch,* 107 F. 2d 812, 814-815 (C.A. 9th); *United States* v. *Pettigrew,* 81 F. 2d 666 (C.A. 9th); *O'Rourke* v. *Commissioner,* 81 F. 2d 668 (C.A. 9th); *Lamb* v. *Smith,* 183 F. 2d 938, 943 (C.A. 3d); *Hayes* v. *Commissioner,* 161 F. 2d 689 (C.A. 10th). Accordingly, the taxpayers' claim for the exclusion of the wife's share of the community net income from Rose's taxable income, as redetermined by the Tax Court, should be denied.

VI

The Tax Court correctly found that the cost basis of taxpayer Rose's Silver King Coalition Mines stock, which he sold in 1941, was not in excess of $4,500 at date of acquisition, as determined by the Commissioner.

The taxpayers contend (Br. 35-36) that the Tax Court erred in sustaining the Commissioner's determination that the cost basis of the 1,200 shares of stock of the Silver King Coalition Mines, which taxpayer Rose sold in 1941, was no greater than $4,500, rather than the $9,600 basis Rose claimed as the cost thereof for computing the long-term capital loss deducted on their 1941 returns (Exs. G. and J). The argument is that the $4,500 basis used by the Commissioner and the Tax Court is wrong because that amount

represented merely the amount of a loan which Rose made against the stock in 1937, whereas he allegedly acquired it as a legal fee "in 1936" when it had a value of $9,600. (Br. 35-36.) This contention is not borne out by the record.

The facts show that the taxpayers claimed the long-term capital loss deduction of $5,547 on the basis of a cost of $9,600 in 1936 and a selling price in 1941 of $4,053 ($4,140, less $87 selling expense), that is, a community loss of $2,773.50 each for 1941. (R. 508, 529-530; Exs. G. and J.) The Commissioner determined that the stock was acquired in 1937 at a cost of $4,500, and therefore the loss in question was sustained in the sum of only $447, of which one-half was deductible by each taxpayer Rose and his wife as a community loss for 1941. (R. 508-509, 529-530.) Section 113 (a), Internal Revenue Code (Appendix, *infra*). The Tax Court, though finding that the stock was acquired by taxpayer Rose *before 1936,* sustained such determination. (R. 439, 443.) Hence, there remain for decision both the date of acquisition and the cost of the stock as of that date.

The taxpayers' statement that the stock in question was actually acquired "in 1936" (Br. 35) is erroneous. In so far as the record shows, they have established neither the date of acquisition nor the cost of the stock at acquisition. (Br. 35-36.) Moreover, they have failed to show that the cost basis of $4,500 determined by the Commissioner and the Tax Court is wrong. So far as the record shows, it is correct. Thus, the Tax Court found, upon the evidence, that taxpayer Rose acquired 2,000 shares of the stock in question "at some * * * date prior to 1936" (R. 443), in lieu of his 50% fee for the recovery of 4,000 shares thereof for Mary Allen in the will contest of her aunt's estate (R. 297-301), such shares having been released by the Probate Court upon Rose's intervention effecting payment of the California inheritance taxes thereon on December 8, 1934 (R. 297, 299, 443; Ex. 96). In so far as the record shows, *that* was the actual date when taxpayer Rose acquired the 2,000 shares of such stock (R. 297-301, 443; Tr. 22, p. 33), the 1,200 shares in controversy, sold by him in 1941, representing a

portion of the 2,000 shares then acquired (R. 297-301, 443; Ex. 96).

Taxpayer Rose stated under oath that he had acquired the stock in 1934, again in 1935, and finally in 1936.[12] (R. 297-301, 503, 523; Ex. G.) His testimony that he had "acquired the right to it in 1934" when Mary Allen's 4,000 shares were obtained from the Probate Court (R. 301), fixes the specific date of acquisition as December 8, 1934, when the Probate Court released the stock (Ex. 96). This is in harmony with taxpayer Rose's statement to the Tax Court (Tr. 22, pp. 33-34) that "the uncontradicted facts in the form of sworn testimony show that these shares of stock were acquired in 1934 as the result of a settlement in the Keith will contest"; but that "the actual possession of said shares by petitioner A. Brigham Rose was not accomplished until 1936". The record shows that the stock was in a single certificate of 4,000 shares, which was turned over to Warner as trustee of Mary Allen's trust—which he used, until later divided between Mary Allen and Rose, as security for making loans on Rose's properties (R. 299, 433, 443). The Probate Court nevertheless allocated 2,000 shares thereof to her which, due to parental objections, were diverted to trustee Warner to augment her trust, and it also

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[12] Thus, taxpayer Rose testified, in answer to the question, "* * * when did you acquire the stock?", that it was "In 1934" (R. 298, 299); and, in answer to the question, "You acquired the right to it in 1934?", he replied, "Yes, by a Court order in probate" (R. 301). Likewise, Rose represented to the Tax Court (Tr. 22, pp. 33, 34) that the sworn uncontradicted facts show that the stock was acquired in 1934 but that actual possession thereof was not obtained by him until 1936. He had testified in contradiction thereto, however, that he was unable to "determine just when this stock * * * came into my possession, actually" (R. 115), although he had stated in his sworn 1941 income tax return that the "Date acquired * * * [was] 1935" (Ex. G, Schedule F); and he later testified that, "I had acquired it *long prior to* that time" [1937], but that "I didn't get the *physical possession* of the stock until 1936, although it was awarded to us [Mary Allen and Rose] in 1934" (R. 298). (Italics supplied.)

ruled that Rose was entitled to his 2,000 shares because it recognized his contingent 50% cash fee contract with Mary Allen entitling him to one-half of whatever she should recover in the will contest of her aunt's estate (R. 299-301). Hence, Rose clearly *acquired title* to his 2,000 shares in 1934 even though the certificate "wasn't separated until later" (R. 300) when Rose got *physical possession* of his shares in 1936 (R. 299). Consequently, the Tax Court's finding that taxpayer Rose acquired the 1,200 shares of stock here in question at some unshown date *prior to* 1936 (R. 443), is correct, and taxpayer Rose's statement to this Court that he "actually acquired" the stock as a fee "in 1936" (Br. 35), is necessarily incorrect. Hence, this in itself should be sufficient to defeat the taxpayer's contentions for their alleged value of $9,600 as of 1936 can have no application as the statutory cost basis for determining the claimed long-term capital loss which, to be deductible, must be the cost in the *actual* year of acquisition—1934 here. Sections 23 (g) (1), 113 (a) and 117 (a) (1), (5) and (9) and (b), Internal Revenue Code (Appendix, *infra*).

Nor have the taxpayers established the cost or fair market value of the 1,200 shares of stock in question as of the date of *actual* acquisition. Contrary to their erroneous statement (Br. 36), the Tax Court, while stating that it could not take the responsibility of acting as counsel for either of the parties, nevertheless admonished taxpayer Rose that he should develop more fully the "tax basis * * * for determining gain or loss with regard to that stock" in question (R. 347), and that "the important thing is the fair market value of this stock as of the time you obtained title to it" (R. 348). In response thereto, however, taxpayer Rose failed to specify or *prove* such value. He merely testified that he had used the value of $8 a share (aggregating $9,600 for 1,200 shares) for the purpose of reporting the long-term capital loss claimed in his 1941 return because he was unable to obtain the necessary records and information from his bank to prove the real value of the stock as of the date of acquisition. (R. 297-298, 347-348; Ex. G.) More-

over, showing his *inability* to establish such value as of the critical date, taxpayer Rose testified that "I can't find these bank records which would show what [value] it was put up for [sale] * * *, so I took * * * The time it did come into my hands, [and] to the best of my recollection, looking back there [at time of acquisition], the stock was worth about $8.00" a share; "So I submitted that figure in my [1941] income tax return. In other words * * * I am not presenting to you the accurate figures. It was merely a sort of a generalization." (R. 348.)

On the other hand, the record shows the fair market value of the stock at acquisition to have been not more than the sum of $4,500, as determined by the Commissioner and the Tax Court. (R. 79-81.) Thus, Revenue Agent Rocco testified that the records of stock brokers J. A. Hogle and Company showed that "in lieu of a basis of $9,600 * * * the acquisition of that stock [was] for the sum of $4,500". (R. 79.) While the taxpayers here, as in the Tax Court (R. 80, 298; Tr. 22, pp. 33-34), insist that the latter amount represented merely the amount of a loan which Rose had made against the stock in 1937 (Br. 35), nevertheless, as shown, they have failed to establish any other amount as the cost *at acquisition* in 1934. As against this, Revenue Agent Rocco testified that while he had never been able to verify exactly what the cost basis of the stock would have been in the year of acquisition, other than as shown by the stock brokers' records (R. 81), neither had he "been able to determine or verify from any records that Mr. Rose paid [an amount] for this stock in excess of the $4,500.00 which is used in the statutory notice" for 1941. (R. 80, 81, 529-530.) Hence, the determination of the Commissioner and the Tax Court of the $4,500 cost basis was the nearest possible cost figure ascertainable under the conflicting evidence adduced by the taxpayers.[13] In these circumstances, it is

[13] Taxpayer Rose's conflicting testimony showed alleged values of the stock in question from time to time, variously, as follows: $10 a share as of Mary Allen's decedent aunt's death (R. 80, 297, 348); "about" $8 a share at "The time it did come into my hands"

clear that in the absence of their establishing either the date of acquisition or that the fair market value *at date of receipt* was in excess of the amount allowed by the Commissioner, the Tax Court, for lack of proof, had no alternative than to find that the cost basis as determined by the Commissioner was "the maximum allowable therefor at the date of acquisition." (R. 443.) Section 113 (a), Internal Revenue Code. It follows that the taxpayers' failure or inability to prove these essential material facts leaves them, upon whom that burden rests, with an unenforcible claim. *Helvering* v. *Bruun,* 309 U. S. 461, 467-468; *Burnet* v. *Houston,* 283 U. S. 223, 227-228; *Helvering* v. *Taylor,* 293 U. S. 507, 514-515.

Helvering v. *Salvage,* 297 U. S. 106, relied on by the taxpayers (Br. 35-36), is not at variance with the Tax Court's findings here for there the basis of the stock at date of acquisition was shown by the evidence. Neither does *Helvering* v. *Taylor, supra,* support their contention (Br. 36) that since the Commissioner, upon rejecting their cost basis of $9,600 shown in their 1941 return (Ex. G), did not ascertain a "substituted" valuation at date of acquisition of the stock differently from his original determination, the Tax Court erred in merely adopting such determination instead of its independently redetermining another valuation—presumably without further evidence adduced by the taxpayers (Br. 36). This novel contention—despite the Tax Court's admonition to taxpayer Rose that *he* had the burden of proof on the material facts (R. 347-348)—would be tantamount to shifting the burden from the taxpayers to the Commissioner, and even to the Tax Court. As shown, this is directly contrary to the authorities. *Welch* v. *Helvering,*

(R. 348) (which he claims as 1936 (Br. 35)); $8 a share when he prepared his 1941 income tax return (R. 297; Ex. G); $3, plus, a share "in the year '39, [when I] sold [such stock] for three dollars and something" (R. 296); and finally, $8 a share, the figure he used in his 1941 tax return which admittedly did not represent "the accurate figures" but "merely a sort of a generalization" (R. 348).

290 U. S. 111, 115; *San Joaquin Brick Co.* v. *Commissioner,* 130 F. 2d 220, 225 (C.A. 9th). In any event, the *Taylor* case is readily distinguishable for there the Supreme Court held that no opportunity had been afforded the taxpayer to adduce evidence before the Board of Tax Appeals, and to try the case on the merits and on the correct theory. Only for that reason, absent here, was the rehearing deemed necessary there. While the taxpayers, of course, are not compelled under that decision to show what "the correct amount of the tax" is, they "must however show in some way at least that the tax imposed is erroneous", and "The failure to do so in this instance leaves the redeterminations made by the Tax Court those which should be given effect." *Hague Estate* v. *Commissioner,* 132 F. 2d 775, 778 (C.A. 2d), certiorari denied, 318 U. S. 787.

VII

The Tax Court properly sustained the Commissioner's determination allowing taxpayers Rose and wife deductions for depreciation on their Vine Street property only to the extent substantiated, and disallowed the remainder, together with Lori's claimed deductions for depreciation on its Villa Courts property, for lack of proof.

The taxpayers contend (Br. 37) that while the rentals received during the taxable years were included in Rose's and Lori's gross income, they were not allowed *any* deductions for depreciation on the buildings of their Vine Street property or the Villa Courts property owned by them, respectively, from which they derived such rentals. They assert this as error on the ground that it was the alleged duty of the Tax Court to redetermine the allowances for depreciation "even if the petitioners' evidence was unsatisfactory". (Br. 37.) There is no basis for this contention.

The taxpayers' statement (Br. 37) that neither the Commissioner nor the Tax Court allowed taxpayers Rose and wife "any" depreciation, is erroneous. It will be noted that the taxpayers reported no income and claimed no deductions for depreciation or otherwise in their return filed for 1938. (R. 526-527; Ex. E.) Nor is any additional

depreciation for the other taxable years, over and above that allowed by the Commissioner and the Tax Court, shown to have been claimed or established at the hearing below. (R. 443-444; 450; Tr. 22, 30.) The record shows that the Commissioner allowed taxpayers Rose and wife deductions for depreciation to the full extent established for the years 1939 to 1941, inclusive, and properly disallowed the remaining amounts for lack of proof. (R. 13-14, 57-58, 439, 527-528, 529.) The Tax Court found, upon the evidence, that they had understated their rental income received from the Vine Street property (comprising land and three buildings), purchased by Rose in 1936 for $22,100 (R. 433), because of their failure to have established any *deductible* expenses for depreciation applicable thereto, in excess of the amounts allowed by the Commissioner (R. 443-444). Since the maximum basis allowable for depreciation purposes is limited to the cost of the buildings, less that of the land (Section 19.23 (l)-2, Treasury Regulations 103 (Appendix, *infra*)), the Commissioner allocated the total cost between the depreciable and the non-depreciable assets, and thereupon determined the depreciable basis of $21,000 for the buildings, and allowed depreciation deductions accordingly as provided by law (Sections 23 (l) and (n), 113 (a) and 114 (a), Internal Revenue Code (Appendix, *infra*)), (R. 14, 58, 439, 528-529). In these circumstances, the Tax Court's findings (R. 439, 443-444), upon the only evidence available, sustaining the Commissioner's determinations, should be affirmed.

As to Lori's depreciation claimed on its Villa Courts property (comprising nine bungalows and a dining room) (R. 432-433, 435-436), the record shows that the Commissioner disallowed the deductions taken therefor for lack of information upon the basis of which allowable depreciation could be determined (R. 473, 475, 477). Quite plainly, if Lori was entitled to depreciation deductions on that property or other depreciable assets for any of the taxable years involved, therefore, it has shown neither records nor other acceptable evidence that it owned depre-

ciable assets having a cost value of $32,000 [14], as claimed in its 1940 and 1941 returns. (R. 464; Exs. C and D.) It deducted depreciation in its 1939 return in the sum of $2,500 which presumably represented depreciation claimed without segregation shown, for both the Brevoort hotel and the Villa Courts properties then under joint lease to Linck. (R. 124, 461-462, 473; Exs. B and Q.) On the other hand, it claimed only $640 depreciation in its returns for each 1940 and 1941 (R. 475, 477; Exs. C and D), without any showing of the depreciable bases therefor. Since Lori's Villa Courts property and the Brevoort hotel were under a joint five-year lease to Linck from February, 1939, to May, 1940, and thereafter under joint lease to others during the rest of that year and all of 1941 and later years (R. 435, 461-462, 463; Exs. Q and 89), there is no showing of any bases or segregation as to what proportion of the aggregate depreciation claimed and deducted for the *two* properties was allocable to Lori's property as against the hotel property, respectively. In these circumstances, the Commissioner obviously had no permissible bases upon which to determine the depreciation allowable, if any, on Lori's Villa Courts property (R. 473, 475, 477.) The Tax Court, therefore, had no alternative than to sustain, upon the evidence, the Commissioner's determination disallowing such depreciation for lack of proof. Sections 23 (l) and (n), 113 (a) and 114 (a), Internal Revenue Code; Section 19.23 (l)-2, Treasury Regulations 103.

Thus, contrary to the taxpayers' statement (Br. 37), deductions for depreciation were allowed them to the full extent of their proof, and necessarily disallowed otherwise. They have given no further evidence, moreover, to

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[14] Taxpayer Rose's statement to the Tax Court that Lori's Villa Courts property, acquired by others in 1930, had "record" "encumbrances in the amount of $38,000.00, augmented by the * * * substantial trust funds of the Mary Allen trust [which] went into this property" (Tr. 22, p. 37), of course, can have no significance in respect of the depreciable bases of the property for the taxable years involved here.

enable this Court to determine what the proper bases were for purposes of depreciation during the taxable years. Nor do they cite any authority for the novel claim that a duty devolves upon the Tax Court to determine an allowance for depreciation upon the basis of their contentions "even if the petitioners' evidence was unsatisfactory". (Pet. Br. 37.) On the contrary, as shown, deductions for depreciation or otherwise may not properly be allowed unless and until the taxpayers have met the burden of overcoming the presumptive correctness of the Commissioner's determination by proper substantiating evidence. *Welch* v. *Helvering,* 290 U. S. 111, 115; *San Joaquin Brick Co.* v. *Commissioner,* 130 F. 2d 220, 225 (C.A. 9th). They have failed to do so here. The several cases cited by the taxpayers (Br. 37), moreover, clearly do not support that proposition. The taxpayers must prove their case, barring which their contentions must be denied. *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590, 593; *Welch* v. *Helvering, supra; San Joaquin Brick Co.* v. *Commissioner, supra; J. M. Perry & Co.* v. *Commissioner,* 120 F. 2d 123, 124-125 (C.A. 9th).

VIII

The corporate identity of Lori may not properly be disregarded for income tax purposes

Taxpayer Lori contends that it was improperly charged with the income included in its bank deposits because it was merely the title holder or agent for taxpayer Rose in respect of the property and funds held in its name, and therefore such income was properly chargeable to taxpayer Rose instead of to Lori. (Br. 22-24.) The argument is that since Lori was engaged solely in the business of holding real estate (Br. 22-23), without any beneficial interest in the property or in the funds received and disbursed in its name, its corporate identity should be disregarded for tax purposes to the end that no taxes should be imposed on it (Br. 24). The record does not support this contention.

In the first place, taxpayer Lori did not raise this issue in the Tax Court (R. 456-466), contending rather that its return for each of the years 1938 to 1941, inclusive (Exs.

A-D), "was a true return" or equally inept words to such effect (Tr. 22, pp. 14-15, 22-23, 27-28, 35-37). Consequently, since the issue was neither presented to nor considered by the Tax Court (R. 426-455), this Court should pass the point. *Helvering* v. *Salvage,* 297 U.S. 106; *General Utilities Co.* v. *Helvering,* 296 U.S. 200, 206.

In the event this Court decides to take cognizance of the new issue, however, it is submitted that the taxpayers have failed to show any substantial or persuasive reasons as to why, under the clear facts here, Lori should be any exception to the general rule that the corporate identity will not be ignored for tax purposes except for the most cogent reasons, absent here. *Moline Properties* v. *Commissioner,* 319 U.S. 436, 438-439; *Rogan* v. *Star Piano Co., Pacific Division,* 139 F. 2d 671, 674 (C.A. 9th). The facts do not warrant this Court's ignoring the corporate entity of Lori for it was clearly not merely an adjunct, agent, instrumentality or nominee of taxpayer Rose's professional or personal business activities. Rather, the record shows that it was a real operating corporation having "general corporate powers" authorizing it to carry on various business activities, and that it was actively engaged in carrying on corporate business operations in holding real estate and all things incidental thereto during the taxable years. (R. 56, 350, 419, 428.)

Thus, the evidence shows that Lori not only held real estate but, as taxpayer Rose testified (R. 419), it engaged in business activities consisting of collecting rents, paying real and personal property taxes, interest on loans, employees' wages, Rose's annual retainer fees, etc. It owned and operated its Villa Courts property, comprising nine bungalows and a dining room (R. 70-73, 432-433), and it was able to and "did borrow thousands of dollars that have gone into this property" during the taxable years (R. 350). It also made other loans from time to time, such as the $7,000 loan from the Citizens Trust Company (R. 126-127), and regularly received "gross sums" of money from the Brevoort Enterprises in order to operate and pay the expenses covering both its Villa Courts properties and the Brevoort

hotel operations (R. 441). It leased its properties jointly with the hotel to others from time to time and collected its rents therefrom. (R. 435-436.) This was in excess of $16,240 alone for 1939 (R. 72-73), and it had gross income around $25,000 a year (R. 72), as the taxpayers state (Br. 23). It had an active bank account with deposits and withdrawals running, variously, in amounts in excess of $25,000 to $35,000 during the taxable years. (R. 445.) It realized taxable net income from its operations in the respective sums of $9,488.13, $8,167.24, $11,965.17 and $9,239.52, as redetermined by the Tax Court, for the taxable years 1938 to 1941, inclusive. (Tr. 61.) In these circumstances, it is apparent that, contrary to the taxpayers' contentions (Br. 22-24), there is an abundance of evidence showing that Lori had a tax identity distinct from taxpayer Rose for it was an active corporation carrying on a going business for profit. Therefore, it was obliged, under the taxing laws, to keep records, make returns of gross and net income, deductions, credits, etc., and pay taxes. *National Carbide Corp.* v. *Commissioner,* 336 U.S. 422; *Moline Properties* v. *Commissioner,* 319 U. S. 436, 438-439; *Higgins* v. *Smith,* 308 U. S. 473, 477; *National Investors Corp.* v. *Hoey,* 144 F. 2d 466, 467-468 (C.A. 2d).

In the *Moline Properties* case involving *much* less business activity than Lori's, the Supreme Court stated (p. 440):

> In 1934 petitioner engaged in an unambiguous business venture of its own—it leased a part of its property as a parking lot, receiving a substantial rental. The facts, it seems to us, compel the conclusion that the taxpayer had a tax identity distinct from its stockholder.

Likewise, *Paymer* v. *Commissioner,* 150 F. 2d 334 (C.A. 2d), is a case almost directly in point. There the Raymep Realty Corporation, with two sole stockholders, was authorized with broad powers to do general corporate business in real estate. It held a single parcel of income-producing real estate, but the two partners managed it, collected the income, paid the expenses, deposited the receipts in Pay-

mer's bank account, and used the corporation's profits of the business as they pleased. Other than thus holding the parcel of real estate, the corporation's *sole* business activity during the taxable year was that of obtaining a single loan of $50,000, and as security it assigned all the lessor's rights. The court held, nevertheless, that this was corporate activity sufficient to serve a business purpose and to justify holding that it did engage in business in that year, and therefore its corporate identity could not be ignored for income tax purposes.

In *National Investors Corp.* v. *Hoey, supra,* the court stated (pp. 467-468)—

> whatever the purpose of organizing the corporation, "so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity." * * *. * * * it merely declares that to be a separate jural person for purposes of taxation, a corporation must engage in some industrial, commercial, or other activity besides avoiding taxation; in other words, that the term "corporation" will be interpreted to mean a corporation which does some "business" in the ordinary meaning; * * *

Applying the rules laid down in the above-cited cases to the facts here, it is readily apparent that Lori must be held to have a distinct corporate identity for income tax purposes, and therefore, contrary to the taxpayers' contentions (Br. 23-24), it is chargeable with its own income and the resulting tax liabilities for the taxable years. See also *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590; *Burnet* v. *Clark,* 287 U. S. 410, 415; *Dalton* v. *Bowers,* 287 U. S. 404, 410; *Burnet* v. *Commonwealth Imp. Co.,* 287 U. S. 413; *Rogan* v. *Star Piano Co., Pacific Division,* 139 F. 2d 671, 674 (C.A. 9th), certiorari denied, 322 U. S. 728; *John L. Denning & Co.* v. *Commissioner,* 180 F. 2d 288, 290-291 (C.A. 10th); *Watson* v. *Commissioner,* 124 F. 2d 437 (C.A. 2d).

The cases cited by the taxpayers (Br. 24), and distinguished hereinafter, are not at variance with the fore-

going decisions, and quite apart from the factual differences between the cases, the Supreme Court's decision in *Higgins* v. *Smith,* 308 U. S. 473, points clearly to the difference in the questions of law involved, as follows (p. 477):

> A taxpayer is free to adopt such organization for his affairs as he may choose and having elected to do *some* business as a corporation, he must accept the tax disadvantages. * * * [Italics supplied.]

Such cases as *Seattle Hardware Co.* v. *Squire,* 181 F. 2d 188 (C.A. 9th), and *Keokuk & Hamilton Bridge* v. *Commissioner,* 180 F. 2d 58 (C.A. 8th), relied on by the taxpayers (Br. 24), are clearly distinguishable. In the *Seattle Hardware* case, this Court, distinguishing *National Carbide Corp.* v. *Commissioner,* 336 U. S. 422, affirmed the judgment of the District Court which had held that the separate entity of the taxpayer's subsidiary corporation should be ignored for tax purposes. The stated reasons were that the subsidiary was merely an instrumentality of the taxpayer's business, under complete domination and control of the taxpayer, without any *business purpose* or activity other than to hold and act as a nominal conduit for the passage of the title to the property in question, as a dummy, from the taxpayer's agent to the taxpayer itself for the taxpayer's use and benefit. Likewise, the *Keokuk* case involves a different factual situation. There the subsidiary corporation acted in the capacity of a mere agency upon its organization to make effective the transfer of the toll bridge as a gift to the city after the corporation's bonded indebtedness had been paid, and therefore it was held not taxable on the income received from operating the bridge during the interim period.

IX

The Tax Court properly sustained the Commissioner's determination disallowing, for lack of proof, Lori's claimed deductions for "related" business expenses paid by others.

The taxpayers contend that if Lori is taxable on any of the income included in any of its bank deposits, it should be allowed deductions for "related expenses" in the re-

spective sums of $10,748.62 and $6,107.21 for the years 1938 and 1939 which were paid by taxpayer Rose out of moneys received by him from Lori. (Br. 25-27.) The argument is that since Lori received from Brevoort moneys in respect of the hotel and Villa Courts and paid them out, through Rose, for the expenses of both the hotel and Villa Courts, there is no apparent reason why such expense items should not be allowed as deductions merely because they were paid through Rose's bank accounts. (Br. 26.) This contention is without basis in the record.

The record shows that the *total* amounts in question were allowed by the Tax Court as a reduction in Rose's taxable income for those years upon his establishing that he had paid the current operating expenses of Lori *and* the hotel in those amounts out of his own bank accounts—which had been augmented by funds he received from Lori, which in turn had received "gross sums" from Brevoort—covering expenses of operation of *both* the hotel and Villa Courts. (R. 441; Pet. Br. 26.) There is no showing, however, that these amounts were not claimed and allowed in whole or in part as deductions to both Lori and/or Brevoort (R. 446-447, 450), as well as to Rose (R. 441). Hence, without more, to allow the same deductions now to Lori would be allowance of double deductions which is not permissible for income tax purposes. Section 23(a)-1 of Treasury Regulations 103. Moreover, the taxpayers admit that Lori paid out these moneys through Rose for both Brevoort's hotel expenses and its own Villa Courts expenses (Br. 26). Therefore, in the absence of any segregation shown in respect of the amounts involved as between those two entities, there is no basis for this Court's allowing them as deductions to Lori. Section 19.23 (a)-1, Treasury Regulations 103 (Appendix, *infra*). The statute and Regulations permit deductions for ordinary and necessary business expenses paid or incurred by the *taxpayer* in carrying on any trade or business during the taxable year, and also provide that "deductible" expenses include only such expenditures as are "directly connected with or pertaining to the taxpayer's trade or business". Section 23(a)(1)(A), Internal Rev-

enue Code; Section 19.23 (a)-1, Treasury Regulations 103 (Appendix, *infra*). They do not allow deductions to the taxpayer for its "related expenses" or its business expenses paid by another, as claimed by taxpayer Lori here. (Br. 25-27.) Hence, there is no basis established for the claimed deductions here because the taxpayers have shown no segregation of the items allegedly representing *Lori's* income and expense deductions. (R. 449-450.)

The evidence shows that while taxpayer Rose was financially involved in both properties (R. 432-433), nevertheless Brevoort handled and operated the hotel and Lori owned and operated the Villa Courts property, and it was agreed that the receipts under the joint leases of the two properties should go one-third to Lori and two-thirds to the Brevoort Hotel enterprises (R. 432-436, 461-462). Aside from the record's showing the *combined* receipts and disbursements—"operating profit before fixed expense" (R. 137)—of both the hotel and Villa Courts for a part of the year 1938 (R. 134-137, 434-435; Ex. 14), the receipts from the leases of those properties (Exs. P, Q and 89) are in evidence only to the extent of cancelled checks totaling $18,877.92 covering a part of 1939 and two payments in the early part of 1940 (Ex. 50). There is no showing, however, of the *total* receipts from such properties covering the rest of those years and the entire year 1941, nor is there any segregation of receipts and disbursements as between Brevoort's hotel and Lori's Villa Courts properties, other than to the limited extent established by taxpayer Rose and thereupon conceded and allowed by the Commissioner and additionally adjusted by the Tax Court. (R. 441, 445-447.)

Moreover, the record shows that these items now claimed by the taxpayers (Br. 25-27) as deductions from Lori's taxable income for 1938 and 1939, as already redetermined by the Tax Court (Tr. 61), represent almost entirely the expenses of Brevoort's hotel enterprise (R. 144-153, 169-170, 197, 201-202, 208-209; Exs. 15-21, 23, 48, 58, 68-69, 86). In fact, one of the items, $940 (Pet. Br. 25), applies to neither the Brevoort hotel nor Lori's Villa Courts, the

record showing that it represents interest paid on mortgage loans on the "Hotel Angie" in Pasadena (R. 201-202; Ex. 69). The only other exceptions thereto (in addition to Lori's taxes, $508.65) are the street bond assessment ($40.09) and the 1937 personal property taxes paid in 1938 ($263.27), levied against *both* the hotel and Lori. (R. 150-151; Exs. 20 and 21.) Since the taxpayers have furnished no segregation as to these amounts (Br. 25), they have not established what portion thereof, if any, is allocable to and therefore deductible by Lori. Even if they were segregated, however, the street bond assessment would not be deductible in any event for that was a capital expenditure (Section 23 (c)(4) of the Revenue Act of 1938 and Section 24 (a) (2) and (3), Internal Revenue Code (Appendix, *infra*)); and the 1937 property tax paid in 1938 is not deductible for the latter year (Section 43, Internal Revenue Code; Section 19.43-2, Treasury Regulations 103 (Appendix, *infra*)). Nor is any part of the item, $1,753.54, representing real estate tax paid on the Brevoort hotel property (R. 208-209; Ex. 86; Pet. Br. 25) shown to have been allocable to Lori's property. Finally, as to the item of 1938 real estate taxes ($508.65) on Lori's property (Br. 25), included in the claimed total deduction of $598.65 for 1938 (R. 149), the taxpayers have not shown that such amount was not allowed to Lori as part of the expenses it had paid out in connection with the operation of "both" the Villa Courts and the hotel in the sum of $9,295, additionally adjusted in Lori's favor by the Tax Court for the year 1938 (R. 447, 450; Tr. 61). Significantly, that amount of $508.65 (Ex. 19), claimed now as a deduction for Lori (Br. 25), is the identical amount shown as paid by taxpayer Rose on behalf of *Brevoort* for that year (Ex. GG).

In any event, there is no evidence showing that taxpayer *Lori,* of and for itself, paid such amount ($508.65) for taxes, or any of the other amounts contended for as "related expenses" which the taxpayers state "apparently" represent the items of business expense claimed for it here. (Br. 25.) Since taxes are ordinarily deductible only by the person upon whom they are imposed (Article 23 (c)-1, Treasury

Regulations 101 (Appendix, *infra*)) and business expenses only by the taxpayer to whose business they directly relate (Section 19.23 (a)-1, Treasury Regulations 103), and taxpayer Rose admittedly paid the items in question out of moneys received from Lori and/or Brevoort (R. 441; Br. 25-26) without any segregation shown, it is apparent that they are not shown to have constituted allowable deductions to Lori. Nor is there any showing that taxpayer Rose paid any such items on behalf of Lori, in excess of the amounts substantiated and therefore conceded by the Commissioner and allowed by the Tax Court upon the taxpayers' adducing further evidence in connection therewith at the hearing below. (R. 440-441, 446; Tr. 61) It is quite plain, therefore, that there is no basis shown for further allowance of these items in that the taxpayers have made no successful effort to establish affirmatively other than by their own contentions that the expenses and taxes they represent have not already been allowed in full or partially at least by the Tax Court in making the further allowances to Lori upon its additional evidence adduced in explanation of the items previously unidentified (R. 446-447), and giving effect thereto upon adopting the Commissioner's recomputations for those years (Tr. 61). Moreover, contrary to the taxpayers' contentions (Br. 26-27), in so far as Lori's and the Brevoort hotel's unsegregated business expenses were paid voluntarily by or through Rose from unsegregated funds received from Lori and/or Brevoort, they do not constitute proper deductions from income for tax purposes for either Rose or Lori for, as the taxpayers admit (Br. 23, 25), they were not, in the case of Lori, paid by the *corporate* taxpayer but by others, and there is no segregation showing whether or to what extent either Rose or Lori was liable therefor. *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590, 593-594; *Deputy* v. *duPont,* 308 U. S. 488, 493-494; *Welch* v. *Helvering,* 290 U. S. 111, 114-115; *Burnet* v. *Clark,* 287 U. S. 410; *Omaha Nat. Bank* v. *Commissioner,* 183 F. 2d 899, 901 (C.A.8th); *Friedman* v. *Delaney,* 171 F. 2d 269 (C.A.1st), certiorari denied, 336 U. S. 936; *Knight-Campbell*

Music Co. v. *Commissioner,* 155 F. 2d 837, 840 (C.A.10th), and cases cited therein; *Chenango Textile Corp.* v. *Commissioner,* 148 F. 2d 296, 297 (C.A.2d).

The cases (*Minnesota Tea Co.* v. *Helvering,* 302 U. S. 609, and *United States* v. *Boston & M. R. Co.,* 279 U. S. 732) relied on by the taxpayers (Br. 26-27), do not support their claim for the deductions in question on behalf of Lori, but hold to the contrary. Those cases stand for the proposition that the payment by another of a taxpayer's debts constitutes taxable income to the debtor for tax purposes. This, conversely, supports our position that such amounts of Lori's business expenses as were paid by Rose on its behalf, do not constitute deductions to Lori but rather income to the extent paid by another.[15]

X

The Tax Court did not err in declining to exclude from Lori's income the sums aggregating $8,156.76 allegedly representing Rose's personal loans deposited in Lori's bank account during 1939-1941, or the sums totaling $3,955 allegedly representing Rose's moneys transferred from his accounts to Lori's account during those years but not income to Lori because they were not rentals allocable to Lori's Villa Courts property.

The taxpayers contend that the moneys borrowed by taxpayer Rose individually and deposited in Lori's account, in

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[15] It is arguable that such payments, voluntarily made by taxpayer Rose, were improperly allowed by the Tax Court as deductions or offsets against his taxable income for the taxable years for the reason that he made the payments in order to "protect and preserve his equities in the various properties [including Lori's Villa Courts], the operations of which inured to his benefit." (R. 441.) Hence, they were not proper deductions from his income but rather were capital contributions representing additional cost of his stock in the corporation. *Burnet* v. *Clark,* 287 U.S. 410, 414; *A. Giurlani & Bro.* v. *Commissioner,* 119 F. 2d 852, 857-858 (C.A. 9th); *Omaha Nat. Bank* v. *Commissioner,* 183 F. 2d 899, 901 (C.A. 8th); *Chenango Textile Corp.* v. *Commissioner,* 148 F. 2d 296 (C.A. 2d); *Blackwell Oil & Gas Co.* v. *Commissioner,* 60 F. 2d 257, 258 (C.A. 10th).

the aggregate sum of $8,156.76, and also the funds in the total sum of $3,955 transferred from his accounts to Lori's account which allegedly did not represent rentals allocable to its Villa Courts property, during the years 1939 to 1941, inclusive, should be excluded from Lori's taxable income for those years. (Br. 27-30). There is no basis for these contentions.

A. *The Tax Court properly sustained the Commissioner's determination including the sums totaling $8,156.76 in Lori's taxable income for the years 1939 to 1941, inclusive*

The taxpayers contend (Br. 27-28) that since Lori's income was determined on the basis of its bank deposits and its bank account was used as a depository of substantial sums in which it had no interest (R. 447), the Tax Court should have excluded the deposit-items here in question from Lori's income for they were of the same character as other items excluded therefrom by the Tax Court (R. 446).

The record shows that the other items excluded from Lori's income, whether or not of the same character, were allowed only upon the taxpayers' adducing additional evidence whereby the Commissioner recognized and conceded and the Tax Court allowed their exclusion from income. (R. 446-447.) Those items, however, were *established* by the taxpayers as properly excludible, whereas the present items have not been identified or proved as not representing income to Lori. The fact that Lori's account was used by taxpayer Rose as a *general* depository for his and others' receipts and deposits, in some of which Lori had no interest (R. 447), as the taxpayers state (Br. 27), together with their lack of records showing segregation of receipts and disbursements of the various taxable entities (R. 431, 434-435, 441, 445, 447), is one of the very reasons they were unable to prove below, as they are here, that these items did not represent income to Lori (R. 449-450). *Roberts* v. *Commissioner,* 176 F. 2d 221, 226 (C.A.9th). In any event, it falls far short of proving that the items here in controversy did

not embrace transactions constituting income to Lori. The taxpayers, without any substantiating books or records, were unable to prove below that these items were improperly included in Lori's income even though they did, with additional evidence, in respect of other items conceded by the Commissioner and allowed by the Tax Court. (R. 446-447, 450.) In so far as the record shows, however, the present items were properly included in Lori's income by the Commissioner and the Tax Court for the years 1939 to 1941, inclusive (R. 472-479; Tr. 61, pp. 3-11), and the taxpayers have shown nothing to the contrary (Br. 27-28). They have not shown affirmatively that the funds in question were not allowed by the Commissioner in his determination or by the Tax Court upon redetermination of Lori's taxable income. Moreover, since these items represent the same transactions in connection with which taxpayer Rose claimed exclusion of such amounts from his taxable income for the same years, they should not be excluded from Lori's income for the same reasons—lack of proof—heretofore shown in respect of their non-excludibility from Rose's income for those years. See Point II, *supra*. *Interstate Transit Lines v. Commissioner,* 319 U. S. 590, 593; *Helvering* v. *Bruun,* 309 U. S. 461, 467-468; *San Joaquin Brick Co. v. Commissioner,* 130 F. 2d 220, 225 (C.A.9th).

B. *The Tax Court correctly sustained the Commissioner's determination including the sums aggregating $3,955 in Lori's taxable income for 1939-1941 as representing rentals allocable to its Villa Courts property*

As to the second group of three items aggregating $3,955, the taxpayers claim that they represented funds transferred from Rose's accounts to Lori's account and not rental receipts from Lori's Villa Courts property. (Br. 28-30.) The record shows, however, that the Tax Court excluded from Lori's taxable income so much thereof as the taxpayers were able to establish as representing transfers of personal loan moneys from Rose's accounts, over-statements of lease receipts properly allocable to the Brevoort hotel and not to Lori's Villa Courts properties, etc., and therefore, again

for lack of proof, it was obliged to disallow the remaining items which the taxpayers could not properly account for or identify as not representing income to Lori. (R. 446-447.) There was no basis for the Tax Court's excluding the items in question from Lori's income because, in so far as the evidence shows, they represented additional rental receipts from the Linck and later leases, partially allocable to each the Brevoort hotel and Lori's Villa Court property. (R. 435-436, 439; Exs. Q and 89.) As shown, however, since the record shows only the unsegregated *combined* rentals received together by both the hotel and Lori for a part of 1939 and the early part of 1940 (Ex. 50), but none for the rest of 1940 or for 1941, the Tax Court had no grounds for excluding from Lori's income any more than the taxpayers could identify as properly allocable to the hotel's portion of the lease receipts, and therefore not income to Lori (R. 446-447, 450; Ex. FF). Likewise here, there is no basis for further allowance of the items in question for the taxpayers have made no effort to establish affirmatively other than by their own contentions that the *hotel's* portions of the lease receipts transferred from Rose's accounts to Lori's account have not already been allowed in whole or in part as exclusions from Lori's income by the Tax Court in making its redetermination of Lori's net income for 1939 to 1941, inclusive. (R. 446-447, 450.)

In these circumstances, contrary to the taxpayers' contention (Bd. 29-30), there was no showing below (R. 446-447) nor is there here, that the amounts in question, to the extent unidentified, did not in fact represent rental receipts properly allocable to Lori's Villa Courts property. Nor, since "all rentals were [first] payable to petitioner" Rose under the joint leases, and thereafter one-third thereof was "to be credited to Lori" (R. 435-436, 461-462; Exs. Q and 89), can it be denied that they were first collected and deposited by Rose in his own account "without making any segregation" between them and his other intermingled funds (R. 434), and thereafter transferred to Lori's account (R. 431, 434, 447, 462). Consequently, so far as the

record shows, there undoubtedly were such transfers from Rose's account, as the taxpayers state (Br. 28-30), but quite plainly there were also transfers to Lori's account of *its* undisclosed share of the rental receipts allocable to its Villa Courts property. Considering the very confused status of the taxpayers' testimony and exhibits (R. 449), as well as the absence of records (R. 436, 449), moreover, it is clear that there is no *reliable* evidence in this record whereby these transactions can be accurately traced, segregated or proved. Hence, regardless of whatever extent to which taxpayer Rose retained in his own accounts or transferred to Lori the unsegregated receipts from the leases (R. 435-436, 447; Pet. Br. 30), the undisclosed portion thereof representing Lori's rentals still remained income to Lori, and was properly so determined by the Commissioner and the Tax Court (R. 446-447, 449-450). *Roberts* v. *Commissioner,* 176 F. 2d 221, 226 (C.A. 9th). As heretofore shown, however, the taxpayers' inability to prove their case because of their very haphazard, inadequate records (Exs. R, 12, 94, 95), totally without regard to the nature of their income and deductions for tax purposes or the possibility of showing their correct income (R. 449-450), all directly contrary to law (Section 54 (a), Internal Revenue Code; Sections 19.41-3 and 19.54-1, Treasury Regulations 103 (Appendix, *infra*)), merely leaves them without remedy on this issue for lack of proof. *Interstate Transit Lines* v. *Commissioner,* 319 U.S. 590, 593-594; *Helvering* v. *Bruun,* 309 U.S. 461, 467-468; *Roberts* v. *Commissioner,* 176 F. 2d 221 (C.A. 9th); *San Joaquin Brick Co.* v. *Commissioner,* 130 F. 2d 200, 225 (C.A. 9th); *Belser* v. *Commissioner,* 174 F. 2d 386, 390 (C.A. 4th), certiorari denied, 338 U.S. 893; *Omaha Nat. Bank* v. *Commissioner,* 183 F. 2d 899, 902 (C.A. 8th).

XI

Lori is not entitled to any excess profits credits in the determination of its excess profits tax liability for any of the taxable years involved.

Lori now contends for the first time that it should be allowed excess profits credits equal to its average net in-

come as redetermined by the Tax Court for the years 1938 and 1939, and that since such credit, under the statutory formula, cannot be mathematically less than 95% of the average base period "excess profits net income" for the second half (1938-1939) of the four-year statutory "average base period" (1936-1939) prescribed by Sections 711 and 713 of the Internal Revenue Code, there can be no excess profits tax liability chargeable against it for unspecified taxable years.[16] (Br. 31-33.)

In the first place, the record shows that this issue was neither presented to nor considered by the Tax Court. (R. 426-455, 456-466; Tr. 32, 39; Exs. A-D.) Therefore, it had no basis or occasion to pass on it. Hence, this Court is not called upon to decide the point but should pass it. *Helvering* v. *Salvage,* 297 U.S. 106; *General Utilities Co.* v. *Helvering,* 296 U.S. 200, 206; *Harvey* v. *Commissioner,* 171 F. 2d 952, 955 (C.A. 9th); *Popular Priced T. Co.* v. *Commissioner,* 33 F. 2d 464 (C.A. 7th); *Hanby* v. *Commissioner,* 67 F. 2d 125 (C.A. 4th).

In the event this Court should see fit to take cognizance of the new issue raised here for the first time, however, it is submitted that Lori has failed to prove that it is entitled to such excess profits credits. Lori first raised this point in its objections (with alternative computations (Tr. 38)), to the Commissioner's recomputation of its tax liabilities for the taxable years, submitted to the Tax Court in compliance with its opinion redetermining all the issues *then* involved in the case (Tr. 61). Lori's objections, however, were not filed until almost two years after the hearing

[16] Taxpayer Lori does not specify the years for which the excess profits credits are claimed. (Br. 31-33.) Since they are applicable only to taxable years beginning after December 31, 1939 (Section 710 (a) of the Internal Revenue Code), however, it is assumed that the credits are claimed for the years 1940 and 1941. Moreover, since this issue was not raised below, we discuss it on the merits only alternatively, and therefore have not deemed it necessary to include the above statutory provisions in the Appendix to this brief. They are reprinted sufficiently for present purposes, however, in the Appendix to the taxpayers' brief (pp. 2-7).

was terminated and the case submitted below (R. 425), and after its first motion for rehearing, without mentioning the new issue [17], had been denied by the Tax Court (Tr. 32). Hence, neither the Commissioner nor the Tax Court was apprised of any claim for excess profits credits. *Commissioner* v. *West Production Co.*, 121 F. 2d 9, 11 (C.A. 5th), certiorari denied, 314 U.S. 682, held that the party (Commissioner here) moved against in administrative proceedings, as here, "has the right *** to be fully advised of the allegations comprising the claim [excess profits credit here] against him", barring which such "new issues cannot be raised at the hearing under Rule 50" which is designed solely "for purposes of preparing the computation in accordance with the issues raised, presented, and determined at the hearing on the merits, and this method should have been followed in this case." *Bankers Coal Co.* v. *Burnet*, 287 U. S. 308, 312-313.

Rule 50 of the Rules of Practice before the Tax Court of the United States prescribes the procedure for computing the correct amount of the deficiency to be entered in its decision after it "has heard and decided the issues raised and presented on the merits. In terms, it directs that the hearing on the computation *** is to be 'confined strictly to the consideration of the correct computation of the deficiency or overpayment resulting from the determination already made, and no argument will be heard upon or consideration given *** any new issues.' ***." *Bankers Coal Co.* v. *Burnet*, 287 U. S. 308, 312-313. The hearing under that Rule is solely for the purpose of enabling the Tax Court to compute the deficiency in accordance with its decision of the issues already raised and presented at the hearing of the proceedings on the merits, and new issues, other than those relating specifically to computation of the tax *on the basis of its findings of fact and opinion*, may not be raised and urged on the hearing on the settlement of the deficiencies under the Rule. *Bankers Coal Co.*

[17] Neither did Lori's second motion for rehearing raise this point. (Tr. 39.)

v. *Burnet, supra,* p. 313; *Harvey* v. *Commissioner,* 171 F. 2d 952, 955 (C.A. 9th); *Sooy* v. *Commissioner,* 40 F. 2d 634 (C.A. 9th); *Fifth Street Bldg.* v. *Commissioner,* 77 F. 2d 605 (C.A. 9th). Just as the Commissioner may not claim increased deficiencies upon an issue not previously asserted under Rule 50 computations (*State Consol. Oil Co.* v. *Commissioner,* 66 F. 2d 648, 650 (C.A. 9th), certiorari denied, 290 U. S. 704; *Commissioner* v. *Sussman,* 102 F. 2d 919 (C.A. 2d); *Commissioner* v. *Erie Forge Co.,* 167 F. 2d 71, 77 (C.A. 3d)), so here Lori may not claim decreased deficiencies upon the excess profits credits issue not previously raised, in its alternative computations under that Rule. As Lori stated in its Brief in Lieu of Personal Appearance Under Rule 50 (Tr. 44), "A computation under Rule 50 must be based entirely upon the established facts found within the four corners of the Court's findings of fact", citing *State Consol. Oil Co.* v. *Commissioner, supra,* and therefore "It necessarily follows that any facts not shown in the Court's findings of fact may not be applied in a computation under Rule 50."

In these circumstances, since nothing in respect of excess profits *credits* was presented to the Tax Court in order to enable it to make the necessary findings, and the taxpayer admits (Br. 32) that "there is no finding by the Tax Court here with respect to the *excess profits net income* of either 1938 or 1939" [italics supplied], which is absolutely essential to a determination of such credits,[18] it is patently impossible to determine upon this record, the requisite excess profits net income, and in turn the claimed excess profits credits. Hence, since Lori did not even present the issue below, much less the necessary information and data in respect of the excess profits net income essential

[18] The Treasury Department has advised counsel for the respondent that the necessary data and information were not furnished by the taxpayer in order to enable the Commissioner to determine or the Tax Court to ascertain and make findings in respect to Lori's excess profits net income, essential to a determination of the excess profits credits.

to a finding of excess profits credits, it is apparent that its claim for credits cannot be allowed for lack of proof.

There is nothing in *Helvering* v. *Taylor,* 293 U. S. 507, relied on by the taxpayers (Br. 33), which required or enabled the Tax Court to make a finding in respect of the highly-technical statutory excess profits net income and/or credits, in view of the taxpayer's admitted failure to have presented the issue in its pleadings or at the hearing below, or to have adduced any evidence permitting it (Br. 32). Nor does *Zimmermann* v. *Commissioner,* 36 B.T.A. 618, 620, reversed and remanded, 100 F. 2d 1023 (C.A. 3d), relied on by Lori (Br. 32), help its case. There the Commissioner's recomputation under Rule 50 giving effect to the Board's decision allowing claimed capital losses to the taxpayers, also injected into the case a *new* item—15% statutory limitation on charitable contributions—which was not contained in the pleadings or presented by the Commissioner at the hearing before the Board. The taxpayers objected thereto as raising a new issue inhibited under that Rule. The Board held, however, that the Commissioner's action in so doing was proper under Rule 50 proceedings because such additional adjustment, even though a new issue not raised in the pleadings or at the hearing below, was necessarily involved in the arithmetical calculations incident to a correct recomputation of tax liability in compliance with its opinion. In harmony therewith, Lori now attempts to inject a new issue in respect of excess profits credits—neither raised in the pleadings nor at the hearing below—through the instrumentality of its objections (with alternative computations) filed to the Commissioner's recomputations submitted under Rule 50 (Tr. 38, 61), as properly constituting merely a mathematical calculation incident to recomputation, "even though no issue respecting that result is raised in the pleadings" (Pet. Br. 32). Lori's contentions in this connection, however, are negatived by the appellate court's setting aside and remanding (100 F.2d 1023, *per curiam*) the *Zimmermann* decision relied on by Lori. Moreover, over and above these considerations, we have already shown that Lori

cannot prevail in any event for lack of proof of material facts.

XII

There is substantial evidence to support the Tax Court's findings sustaining the Commissioner's determinations of the 50% fraud penalties against the taxpayers for all taxable years involved because "any" of the deficiencies asserted for those years were due to fraud with intent to evade taxes.

The issue here is whether the findings of the Tax Court that the several taxpayers are liable for the 50% fraud penalties imposed as statutory additions to the deficiencies in taxes asserted by the Commissioner and sustained in part by the Tax Court for the taxable years 1938 to 1941, inclusive, are supported by the record. The Commissioner asserted the 50% fraud penalties as additions to the deficiencies determined against all the taxpayers for all four taxable years involved, except the separate liability of taxpayer Rose's wife for the years 1939 and 1941,[19] under sections 22 (a) and 293 (b), respectively of the Internal Revenue Code (Appendix, *infra*). (R. 451.) The Tax Court sustained the determinations in part and thereupon found, "upon the record as a whole" (R. 452), that, with the exception noted, the returns filed by the taxpayers for the taxable years involved were fraudulent; that the taxpayers intended by their actions and omissions to evade taxes (Exs. A. to J, inclusive); and that the Commissioner had sustained his burden of proof in respect of fraud for each taxable year involved (R. 444, 449, 451-454). The taxpayers contend that this was error. (Br. 40-44.)

It is settled that whether an understatement of or failure to report income was due to fraud presents solely a ques-

[19] While fraud was determined by the Commissioner and sustained by the Tax Court against both taxpayer Rose and his wife in respect of their return filed jointly for the year 1940 (R. 13, 444; Ex. H), it was not found against her for the year 1938 for which he filed a return singly (Ex. E), or for 1939 and 1941 for which she filed separate returns (R. 444, Exs. I and J). Fraud was charged against taxpayers Rose and Lori, however, for all taxable years involved. (R. 444, 449; Exs. A-H.)

tion of fact, and that the Tax Court's determination is final if supported by substantial evidence and is not "clearly erroneous". *Helvering* v. *Kehoe,* 309 U. S. 277, 279; *Rogers* v. *Commissioner,* 111 F. 2d 987 (C.A. 6th); *Hoefle* v. *Commissioner,* 114 F. 2d 713, 714-715 (C.A. 6th); *Cohen* v. *Commissioner,* 176 F. 2d 394, 399-400 (C.A. 10th); *Greenfeld* v. *Commissioner,* 165 F. 2d 318 (C.A. 4th); *Halle* v. *Commissioner,* 175 F. 2d 500, 503-504 (C.A. 2d), certiorari denied, 338 U. S. 949; *Heyman* v. *Commissioner,* 176 F. 2d 389, 393-394 (C.A. 2d), certiorari denied, 338 U.S. 904; *Harris* v. *Commissioner,* 174 F. 2d 70, 72 (C.A. 4th); Rule 52(a), Federal Rules of Civil Procedure; *United States* v. *Gypsum Co.,* 333 U.S. 364, 394-395, rehearing denied, 333 U.S. 869; Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948, c. 646, 62 Stat. 869, 991 (26 U.S.C. 1946 ed., Supp. II, Sec. 1141). As stated in *National City Bank of New York* v. *Helvering,* 98 F. 2d 93, 96 (C.A. 2d):

> Although fraud must be well proved, the taxpayer has the burden of showing that the Commissioner was wrong and that the Board had no basis for its finding.

"Fraud cannot be lightly inferred, but must be established by clear and convincing proof." *Rogers* v. *Commissioner, supra,* p. 989. The obligation of the Commissioner to prove it, however, relates only to the penalty and not to the correctness of the deficiency. *Cohen* v. *Commissioner,* 9 T.C. 1156, affirmed, 176 F. 2d 394 (C.A. 10th). It is settled that "there is no burden upon the Government to prove its case beyond a reasonable doubt". *Helvering* v. *Mitchell,* 303 U. S. 391, 403; *Spies* v. *United States,* 317 U.S. 492, 495.

The taxpayers, in attempted expiation of their obvious fraud (R. 452), make great pretense of ignorance of the law even though taxpayer Rose, the controlling member of the group, has been a prosperous and successful lawyer for some years in Los Angeles (R. 428-429). In this connection, the fact should not be overlooked that such a taxpayer would ordinarily be no unlettered person, ignorant of the

methods of business and the purlieus of the law, while carrying on a successful practice under the keen competition that obtains in the metropolis of the West Coast. Cf. *Halle* v. *Commissioner,* 175 F. 2d 500, 502 (C.A. 2d), certiorari denied, 338 U. S. 949. Nevertheless taxpayer Rose, trapped in the dilemma of his own making, now disingenuously represents to this Court (Br. 40, 41) that he is "a helpless infant in accounting and income tax matters", as shown by the fact that he filed his and his controlled-corporation Lori's 1938 tax returns disavowing thereon any income or tax liability for either, whereas the Tax Court redetermined large amounts of taxable net income for both for that year (Tr. 61, 81). This, he states (Br. 41), makes obvious his inability to have differentiated between income, receipts, expenses, disbursements and obligations (presumably in income tax matters). This is made further manifest, he argues (Br. 42), by his principal contention, as below (R. 450), that since most of the moneys received by him and his controlled entities (R. 431-436) were paid out indiscriminately from year to year without records kept or segregation made as to the nature of their expenditures so far as tax deductions were concerned, their taxable income was no greater than that which they had reported for each year, and therefore the returns were necessarily correct as filed (R. 431, 434, 435, 436, 447, 449). The Tax Court rejected these contentions as totally lacking in merit. (R. 450.)

We doubt that, under the facts here, this Court will be impressed with taxpayer Rose's professed ignorance of the law and accounting, totally unaware of the requirements of the federal income tax laws, in his attempt to excuse the false returns in question. In *Wickham* v. *Commissioner,* 65 F. 2d 527 (C.A. 8th), where the taxpayer made a like claim, the court stated (pp. 531-532): "This testimony did not impress the Board of Tax Appeals, nor has it impressed us." Even if this contention were true, however, lack of familiarity with the tax laws and Regulations is no valid excuse. As the court stated in respect of the

"unlearned" taxpayer in *Harris* v. *Commissioner,* 174 F. 2d 70, 71-72 (C.A. 4th):

> It is true that he was deficient in those capacities that make for accurate accounting, but he was prudent and canny enough to amass a considerable fortune in the business world so that at the end of the period his net worth was substantially greater than it was at the beginning. This fact cannot be denied, even though the estimate of the Tax Court that he was worth some $80,000 more in 1942 than in 1934 may be disputed.

Likewise it cannot be denied that taxpayer Rose, the alleged helpless infant in income tax matters (Br. 40), who knew not the difference between income and receipts, expenses and disbursements, or expenses and obligations (Br. 41), nevertheless proved his capacity for amassing considerable wealth, without reporting it as income, whether or not the Tax Court's finding of a substantial increase in his net worth during the taxable years (R. 431-436, 443, 444; Ex. S; Br. 20-21), may be disputed. A casual reading of the revealing provisions of Exhibit HH in respect of Rose's acquisition of Mary Allen's assets, will leave no doubt in the matter.

Contrary to the taxpayers' contentions (Br. 40-44), the clear and convincing evidence of record does not warrant this Court's absolving them from the charges of fraud. The Commissioner fully sustained his burden of proof on the fraud issues by showing that the taxpayers realized large but unexplained sums of money from the operation of taxpayer Rose's legal profession as well as from his controlled business operations—Lori, Brevoort Enterprises, the hotel, and Villa Courts, etc.—which they failed to account for or report in their tax returns. (R. 451-452). The Tax Court made findings of its own in respect of fraud for all four years involved (R. 444, 449, 452-454), and the entire evidence of record shows that no other factual conclusions were possible than that the returns filed by the several taxpayers were false and fraudulent, and that—with the exception noted—"any" of the deficiencies in controversy

were due to fraud with intent to evade taxes (R. 444, 449), within the meaning of Section 293 (b) of the Internal Revenue Code. The Tax Court's findings are abundantly supported by the record.

Thus, the Tax Court found, upon all the evidence, that all the taxpayers together who had reported an aggregate net income of only $37,801.46 (Exs. A-J) for the taxable years involved had thereby understated their true income by more than $80,000 for those years (Tr. 35, 61, 71, 81; Br. 20). The Tax Court also found upon the evidence (R. 444, 449) that—

> Any deficiencies in tax due from petitioner in the years 1938, 1939, and 1941, and from petitioner and his wife in the year 1940, are due to fraud with intent to evade tax.
>
> * * * *
>
> Any deficiencies against Lori are due to fraud with intent to evade taxes.

Likewise, it found in its opinion (R. 452, 454) that—

> We are convinced that, upon the record as a whole, petitioners were fraudulent, and intended, by their actions and/or omissions, to evade tax.
>
> * * * *
>
> Our discussion with reference to the fraud penalties determined against the individual petitioners is equally applicable to Lori, the corporate petitioner. * * *

Upon reading the Tax Court's opinion one is readily impressed with the fairness with which the taxpayers were treated. The Tax Court nevertheless, upon a consideration of all the facts and circumstances, found that they were guilty of an *intent* to file false and fraudulent returns for each of the four years involved. (R. 452.) In so finding, it was not unmindful of the statute (Section 1112 of the Internal Revenue Code (Appendix, *infra*)) which places upon the Commissioner the burden of establishing fraud by clear and convincing evidence. (R. 444, 449, 451-454.) In this connection, the Tax Court pointed out that the Commis-

sioner had shown that large unexplained amounts of money had passed through the taxpayers' various bank accounts during the taxable years which in large part not even the taxpayers could identify or explain, and that this must be considered as substantial evidence in determining fraud. (R. 452.) From these facts, the Tax Court was warranted in finding clear and convincing proof that all the taxpayers filed fraudulent returns and that they intended by their actions and omissions to evade taxes for each of the four years involved. (R. 452-454.) *Rogers* v. *Commissioner,* 111 F. 2d 987, 989 (C.A.6th); *Hoefle* v. *Commissioner,* 114 F. 2d 713 (C.A.6th); *Battjes* v. *United States,* 172 F. 2d 1, 5 (C.A.6th); *Cohen* v. *Commissioner,* 176 F.2d 394 (C.A.10th); *Harris* v. *Commissioner,* 174 F. 2d 70 (C.A.4th); *Stinnett* v. *United States,* 173 F. 2d 129 (C.A.4th), certiorari denied, 337 U.S. 957; *Halle* v. *Commissioner,* 175 F. 2d 500, 504 (C.A.2d), certiorari denied, 388 U. S. 949; *National City Bank of New York* v. *Helvering,* 98 F. 2d 93, 96 (C.A.2d); *Heyman* v. *Commissioner,* 176 F. 2d 389, 394 (C.A.2d), certiorari denied, 338 U.S. 904; *Greenfeld* v. *Commissioner,* 165 F. 2d 318, 320-321 (C.A.4th); *Humphreys* v. *Commissioner,* 125 F. 2d 340 (C.A.7th), certiorari denied, 317, U. S. 637; *Seifert* v. *Commissioner,* 157 F. 2d 719 (C.A.2d); *Maddas* v. *Commissioner,* 114 F. 2d 548 (C.A.3d).

The fact that the taxpayers failed to report substantial amounts of income consistently from year to year is in itself evidence of fraud. *Rogers* v. *Commissioner, supra,* p. 989; *Halle* v. *Commissioner, supra,* p. 503; *Mitchell* v. *Commissioner,* 89 F.2d 873 (C.A.2d), reversed on other grounds, 303 U. S. 391.[20] During the four taxable years involved the taxpayers, individual and corporate, reported *less than one-*

[20] In the *Mitchell* case the Court of Appeals held that there was ample evidence to sustain the finding of the Board of Tax Appeals (now the Tax Court) that there was fraud with intent to evade the tax, but that Mitchell's prior acquittal on the charge of violation of a criminal statute relating to fraudulent evasions of income tax prevented the imposition of the 50% penalty. The Supreme Court reversed on that issue.

third of their aggregate taxable net income (R. 429-430, 448; Exs. A-J), as redetermined by the Tax Court (Tr. 35, 61, 71, 81). Nevetherless, they insist, as in the Tax Court (Tr. 22), that their returns were correct or reasonably so, as filed (Br. 21), and state somewhat unconvincingly, "Call that what you will, it is the very antithesis of fraud" (Br. 42). There were no statements or indications whatever in any of the taxpayers' returns to put the Commissioner on notice that the amounts of net income, if any, as reported therein represented grossly understated sums for the years in which the taxpayers had in fact realized and concealed large amounts of income. (Exs. A-J.) On the contrary, there were statements on their returns clearly designed to mislead the Commissioner—taxpayer Rose's filing his and his controlled corporation Lori's 1938 returns reporting no taxable income but stating thereon, "I Owe Nothing", and "This corporation has gone into debt for the year 1938 and made no profits" (R. 429, 448; Exs. A, E), for example, despite the fact that the Tax Court redetermined taxable net income for each in the sums of $8,203.32 and $9,488.13 for that year (Tr. 61, 81), respectively. The mere suggestion that a person of taxpayer Rose's legal and business capacities could have taken in individually, as well as through his various corporate and other business enterprises, and personally handled over a period of four successive years a total sum in excess of $80,000, an average of more than $20,000 a year, and still have reported only approximately $37,000, an average of only $9,250 annually, without concealment in mind for those years, stretches one's imagination beyond credulity. During the years 1939 to 1941, inclusive, for example, taxpayer Rose had deposited and withdrawn approximately $60,000 in his three special accounts and approximately $77,500 in Lori's account. (R. 430-431, 445.) During all years taxpayer Rose received professional fees, of which, typically, $44,227 received in the years 1939 and 1941 he failed to deposit in his personal bank accounts, or report in his returns for those years. (R. 442.)

In *Rogers* v. *Commissioner,* 111 F. 2d 987, the court stated (p. 989):

> It is conceivable that taxpayers may make minor errors in their tax returns, or, owing to different or contradictory theories of tax computation, calculate returns which differ greatly in result from the Commissioner's assessments. Here petitioners do not have that excuse. Discrepancies of 100% and more between the real net income and the reported income for three successive years strongly evidence an intent to defraud the Government. The Board did not err in deciding that 50% penalties should be assessed.

To the same effect, see *Commissioner* v. *Dyer,* 74 F. 2d 685 (C.A.2d), certiorari denied, 296 U. S. 586 (where the court said (p. 686): "Could any doubt exist, it is laid to rest by the repetition of the ritual in the second year"); *Seifert* v. *Commissioner,* 157 F. 2d 719 (C.A.2d); *Harris* v. *Commissioner,* 174 F. 2d 70, 72 (C.A.4th).

In *Gano* v. *Commissioner,* 19 B. T.A. 518, the Board of Tax Appeals stated (p. 533):

> A failure to report for taxation income unquestionably received, such action being predicated on a patently lame and untenable excuse, would seem to permit of no difference of opinion. It evidences a fraudulent purpose.

In these circumstances, it is apparent that the whole situation here indicates quite clearly a *continuing* studied plan of fraud whereby the taxpayers, by failing to keep adequate records of their receipts and disbursements and the segregation thereof for tax purposes (R. 434, 452) succeeded in concealing most of their taxable income from the taxing authorities, to the end that it *appeared,* as they contended in the Tax Court (R. 450), that their "taxable income was no greater than that reported" for all taxable years. After all, taxpayer Rose did use Lori's account as a "sanctuary" to prevent his *creditors* from further attaching his accounts,

as previously. (R. 431.) He "may be presumed to intend the necessary and natural consequences of his acts." *Myres* v. *United States,* 174 F. 2d 329, 334 (C.A.8th), certiorari denied, 338 U. S. 849. Hence, since the taxpayers here followed the same plan or course of conduct through all the taxable years to defraud the Government of taxes due by grossly understating their income (R. 452), their "fraudulent intent" or motive for each particular year's acts may properly be shown by the "evidence of other [years'] acts and doings of the party of a kindred character". *Wood* v. *United States,* 16 Pet. 342, 360; *Himmelfarb* v. *Commissioner,* 175 F. 2d 924, 941 (C.A.9th), certiorari denied, 338 U. S. 860; *Rogers* v. *Commissioner,* 111 F. 2d 987, 989 (C.A. 6th); *Malone* v. *United States,* 94 F. 2d 281, 287 (C.A.7th), certiorari denied, 304 U. S. 562. Consequently, a consideration of all the evidence affords clear and convincing proof that the taxpayers knowingly and "consistently cheated the Treasury" in evading their income taxes for all taxable years involved. *Seifert* v. *Commissioner,* 157 F. 2d 719 (C.A.2d). As aptly stated by the court in *Heyman* v. *Commissioner,* 176 F. 2d 389, 394 (C.A.2d), certiorari denied, 338 U.S. 904, "We think the situation as a whole was shown to have been instinct with fraud and that the finding of the Tax Court, far from being erroneous, was plainly right." It follows that the Commissioner's determination and the Tax Court's findings of fraud with intent to evade taxes must be accepted as correct. Section 293 (b), Internal Revenue Code; *Rogers* v. *Commissioner, supra,* p. 989; *Hoefle* v. *Commissioner,* 114 F. 2d 713 (C.A.6th); *Cohen* v. *Commissioner,* 9 T.C. 1156, affirmed, 176 F. 2d 394 (C.A. 10th); *Halle* v. *Commissioner,* 175 F. 2d 500, 503 (C.A.2d), certiorari denied, 338 U. S. 949; *Harris* v. *Commissioner,* 174 F. 2d 70, 73 (C.A.4th).

The cases cited by the taxpayers (Br. 42-43) are distinguishable. Moreover, since each fraud case necessarily turns upon its own peculiar facts, their cases do not help. As the court stated in *Eisenberg* v. *Commissioner,* 161 F. 2d

506, 510 (C.A.3d), certiorari denied, 332 U. S. 767, in respect of cases involving strictly fact questions—

> Little can be accomplished toward ultimate determination of the tax responsibility, at least in this class of cases, by ferreting out analogous parts of other cases, particularly since "no one fact is decisive." It is well-settled that the Tax Court's determination, if supported by the facts, is conclusive. That we would not be inclined to draw the same conclusions or make the same inference is of no significance whatever. * * *

Suffice it to say, a situation exists here comparable to that in *Rogers* v. *Commissioner, supra,* where the taxpayer reported less than one-half of his income, and the court stated (p. 989) that:

> The Board's finding is one of fact, and, if supported by clear and convincing evidence, should be affirmed. Such clear and convincing evidence [of fraud] existed here.

In view of the foregoing, it is clear that, contrary to the taxpayers' contentions, there is an abundance of evidence, clear and convincing, sustaining the Tax Court's findings of fraud, and since they have not shown them to be in any wise erroneous, the Tax Court's decisions to such effect, under the provisions of Section 293 (b) of the Revenue Act of 1938 and of the Internal Revenue Code, should be affirmed by this Court.

CONCLUSION

The decisions of the Tax Court in respect of all the taxpayers, individual and corporate, are correct, and should therefore be affirmed upon review by this Court.

Respectfully submitted,

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FEBRUARY, 1951

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(c) *Taxes Generally.*—Taxes paid or accrued within the taxable year, except—

* * * *

(4) taxes assessed against local benefits of a kind tending to increase the value of the property assessed; * * *

* * * *

SEC. 51. INDIVIDUAL RETURNS.

* * * *

(b) *Husband and Wife.*—In the case of a husband and wife living together the income of each (even though one has no gross income) may be included in a single return made by them jointly, in which case the tax shall be computed on the aggregate income, and the liability with respect to the tax shall be joint and several. * * *

* * * *

Internal Revenue Code:

SEC. 21. NET INCOME.

(a) *Definition.*—"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

* * * *

(26 U.S.C. 1946 ed., Sec. 21.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or

interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(e) *Distributions by Corporations.*—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

* * * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

* * * *

(g) *Capital Losses.*—

(1) *Limitation.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

* * * *

(l) [As amended by Sec. 121 (c) of the Revenue Act of 1942, *supra*] *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect

of any property shall be as provided in section 114 * * *

* * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses;

(2) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

(3) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made;

* * * *

(26 U.S.C. 1946 ed., Sec. 24.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

* * * *

(26 U.S.C. 1946 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) [As amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687] *General Rule*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such

amounts are to be properly accounted for as of a different period. * * *

* * * *

(26 U.S.C. 1946 ed., Sec. 42.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U.S.C. 1946 ed., Sec. 43.)

SEC. 45. ALLOCATIONS OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades, or businesses.

SEC. 52. CORPORATION RETURNS.

(a) *Requirement.*—Every corporation subject to taxation under this chapter shall make a return stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice president, or other principal

officer and by the treasurer, assistant treasurer, or chief accounting officer. * * *

* * * *

(26 U.S.C. 1946 ed., Sec. 52.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

* * * *

(26 U.S.C. 1946 ed., Sec. 54.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; * * *

* * * *

26 (U.S.C. 1946 ed., Sec. 113.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * *

(26 U.S.C. 1946 ed., Sec. 114.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business) * * *

* * * *

(5) *Long-term capital loss.*—The term "long-term capital loss" means loss from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such loss is taken into account in computing net income;

* * * *

(9) *Net long-term capital loss.*—The term "net long-term capital loss" means the excess of long-term capital losses for the taxable year over the long-term capital gains for such year.

(b) *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 18 months;

66-2/3 per centum if the capital asset has been held for more than 18 months but not for more than 24 months;

50 per centum if the capital asset has been held for more than 24 months.

* * * *

(26 U.S.C. 1946 ed., Sec. 117.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

* * * *

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612 (d) (2).
(26 U.S.C. 1946 ed., Sec. 293.)

SEC. 1112. BURDEN OF PROOF IN FRAUD CASES.

In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect to such issue shall be upon the Commissioner.
(26 U.S.C. 1946 ed., Sec. 1112.)

The above-quoted provisions of the Internal Revenue Code are substantially the same as the corresponding sections of the Revenue Act of 1938. Hence, references to these sections are, for convenience, to the Internal Revenue Code only.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

> ART. 23 (c)-1. *Taxes.*—* * *. In general taxes are deductible only by the person upon whom they are imposed. * * *

Treasury Regulations 103, promulgated under the Internal Revenue Code:

> SEC. 19.22 (a)-1. *What included in gross income.*—
>
> * * * *
>
> If property is transferred by a corporation to a shareholder, or by an employer to an employee, for an amount substantially less than its fair market value, regardless of whether the transfer is in the guise of a sale or exchange, such shareholder or employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value to the extent that such difference is in the nature of (1) compensation for services rendered or to be rendered or (2) a distribution of earnings or profits taxable as a dividend, as the case may be. * * *
>
> * * * *
>
> SEC. 19.22 (a)-3. *Compensation paid other than in cash.*—If services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income. * * *
>
> SEC. 19.23 (a)-1. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business * * *. Double deductions are not permitted. * * *
>
> SEC. 19.23 (l)-2. *Depreciable property.*—* * * It [depreciation] does not apply * * * to land apart

from the improvements or physical development added to it. * * *. The deduction of an allowance for depreciation is limited to property used in the taxpayer's trade or business. * * *.

SEC. 19.41-1. *Computation of net income.*—* * *. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. * * *. If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

SEC. 19.41-3. *Methods of accounting.*—* * *. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. (See section 54 and section 19.54-1.) Among the essentials are the following:

* * * *

(2) Expenditures made during the year should be properly classified as between capital and expense; * * *

* * * *

SEC. 19.43-2. *When charges deductible.*—Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities, or deficit of one year cannot be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he cannot deduct them from the income of the next or any succeeding year. * * *

SEC. 19.54-1. *Records and income tax forms.* Every person subject to the tax, except persons whose gross income (1) consists solely of salary, wages, or similar compensation for personal services rendered, or (2) arises solely from the business of growing and selling products of the soil, shall, for the purpose of enabling the Commissioner to determine the correct amount of income subject to the tax, keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of the gross income and the deductions, credits, and other matters required to be shown in any return under chapter 1. Such books or records shall be kept at all times available for inspection by internal-revenue officers, and shall be retained so long as the contents thereof may become material in the administration of any internal-revenue laws.

Articles 22 (a)-1, 22 (a)-3, 23 (a)-1, 23 (l)-2, 41-1, 41-3, 43-2 and 54-1 of Treasury Regulations 101, promulgated under the Revenue Act of 1938, contains provisions substantially the same as the above-quoted provisions of Treasury Regulations 103. Hence, references to these sections are, for convenience, to Treasury Regulations 103 only.

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